IN THIS CHAPTER, YOU WILL LEARN:

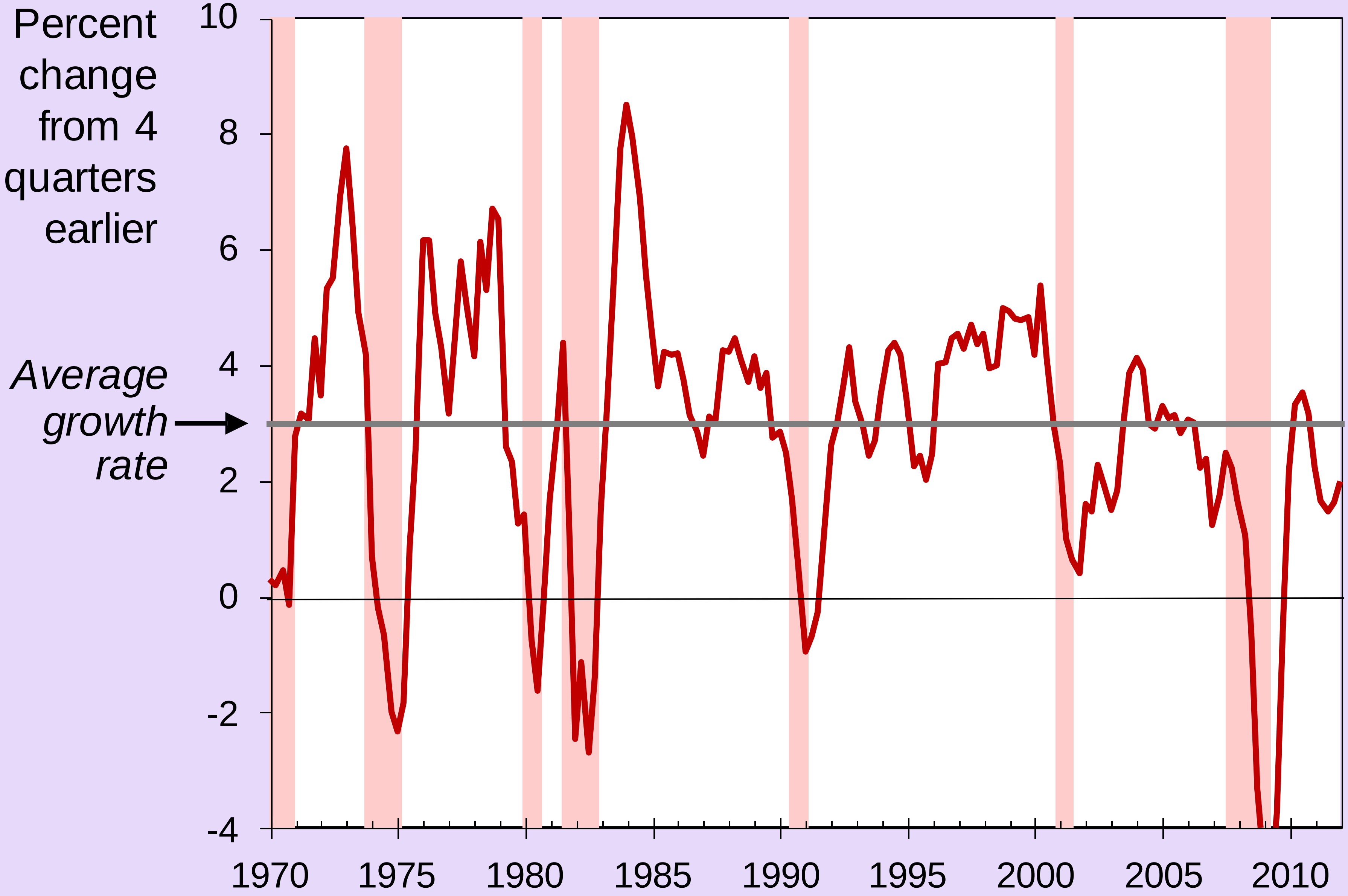
about two policy debates:

1. Should policy be active or passive?
2. Should policy be by rule or discretion?

Question 1:

Should policy be active or passive?

Growth rate of U.S. real GDP



Increase in unemployment during recessions

peak	*trough*	*increase in no. of unemployed persons (millions)*
July 1953	May 1954	2.11
Aug 1957	April 1958	2.27
April 1960	February 1961	1.21
December 1969	November 1970	2.01
November 1973	March 1975	3.58
January 1980	July 1980	1.68
July 1981	November 1982	4.08
July 1990	March 1991	1.67
March 2001	November 2001	1.50
December 2007	June 2009	6.14

Arguments for active policy

- Recessions cause economic hardship for millions of people.
- The Employment Act of 1946:
  "It is the continuing policy and responsibility of the Federal Government to…promote full employment and production."
- The model of aggregate demand and supply (Chaps. 10–14) shows how fiscal and monetary policy can respond to shocks and stabilize the economy.

Arguments against active policy

Policies act with long & variable lags, including:

inside lag:

the time between the shock and the policy response.

- takes time to recognize shock
- takes time to implement policy, especially fiscal policy

outside lag:

the time it takes for policy to affect economy.

If conditions change before policy's impact is felt, the policy may destabilize the economy.