# Discretionary or Not?

After watching Jacob Clifford’s “Long-Run Aggregate Supply, Recession, and Inflation (*LRAS*)” (<https://www.youtube.com/watch?v=a2azB2eag5I>), answer the following questions.

* 1. Explain the idea of using a vertical long run curve to show the long-run aggregate supply.
  2. Explain why showing the vertical long-run aggregate supply to the left of the intersection of AD and AS will define an inflationary gap in the economy.
  3. Explain why showing the vertical long-run aggregate supply to the right of the intersection of AD and AS will define a recessionary gap in the economy.
  4. Define discretionary fiscal policy.
  5. Using discretionary fiscal policy, determine a strategy to correct the inflationary gap.
  6. Using discretionary fiscal policy, determine a strategy to correct the recessionary gap.
  7. Define automatic stabilizers.
  8. Can you suggest any change in automatic stabilizers that might correct the inflationary or recessionary gaps discussed in the video?

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**Answer Key**

After watching Jacob Clifford’s “Long-Run Aggregate Supply, Recession, and Inflation (*LRAS*)” (<https://www.youtube.com/watch?v=a2azB2eag5I>), answer the following questions.

1. Explain the idea of using a vertical long run curve to show the long-run aggregate supply.

*In the long-run, resources are fixed and the economy operates at the full employment, full production level of output.*

1. Explain why showing the vertical long-run aggregate supply to the left of the intersection AD and AS will define an inflationary gap in the economy.

*When the short-run AD and AS equilibrium shows output beyond the full employment, full production level of output, the economy will show inflation as prices are bid up as resources become more scarce.*

1. Explain why showing the vertical long-run aggregate supply to the right of the intersection AD and AS will define a recessionary gap in the economy.

*When the short-run AD and AS equilibrium shows output less than the full employment, full production level of output, the economy is inside the Production Possibility Curve as resources are not fully utilized.*

1. Define discretionary fiscal policy.

*New laws made by Congress that change spending or taxes to fix a problem in the economy.*

1. Using discretionary fiscal policy, determine a strategy to correct the inflationary gap. *Congress can raise tax rates and/or lower government spending to decrease the AD and allow the short-run AD and AS equilibrium to arrive back at the output where long-run Aggregate Demand and Aggregate Supply exists.*
2. Using discretionary fiscal policy, determine a strategy to correct the recessionary gap. *Congress can lower tax rates and/or raise government spending to increase the AD and allow the short-run AD and AS equilibrium to arrive back at the output where long-run Aggregate Demand and Aggregate Supply exists.*
3. Define automatic stabilizers. *Automatic stabilizers based on laws that automatically speed up or slow down the economy without making a new law.*

Can you suggest any change in automatic stabilizers that might correct the inflationary or recessionary gaps discussed in the video? *Changes in the progressive nature of the tax system or changes in the entitlement programs of the government may be ways to use the power of the automatic stabilizers*