

Use the keyboard navigation keys to move forward & backward.

You may also use the spacebar to move forward.

Questions? Email dwheat@wheatresources.com

Supply Side Tutorial

Prepared for students in ECO201

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Overview

In the Feedback story, you learned about the **main reinforcing loop** in an economy and one important **counteracting loop** that keeps the main loop from spiraling out of control.

The **Supply Side** of the economy is where production decisions are made. In this story, you will study three new examples of feedback loops that influence supply-side decision making.

Keep in mind a fundamental premise of this course:

The characteristic behavior of an economy depends on its feedback structure -- the interaction of reinforcing and counteracting feedback loops.

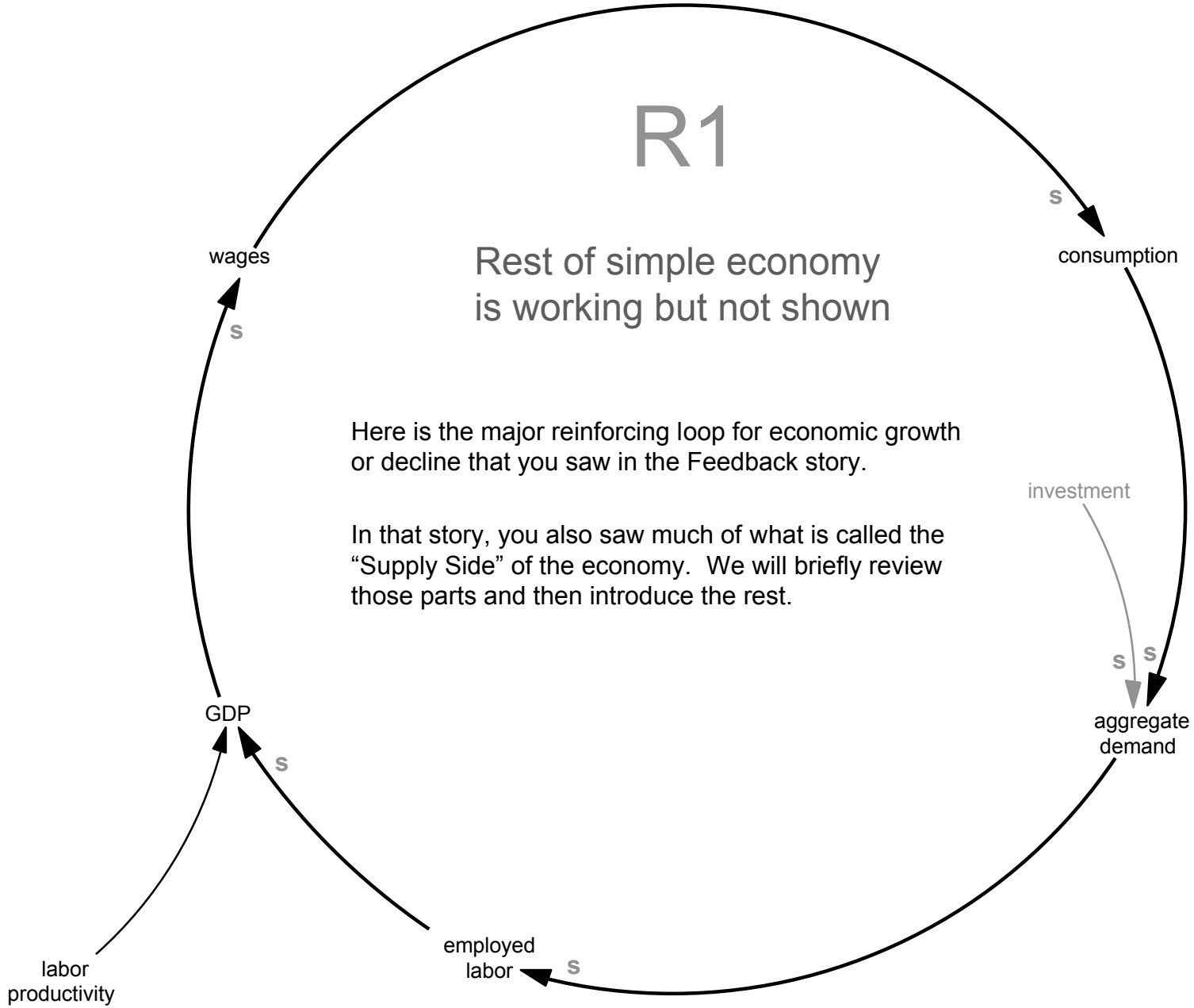
Also, we are still working with a simplified version of the U.S. economy -- one with a fixed money supply, no government taxation or spending, and no foreign trade.

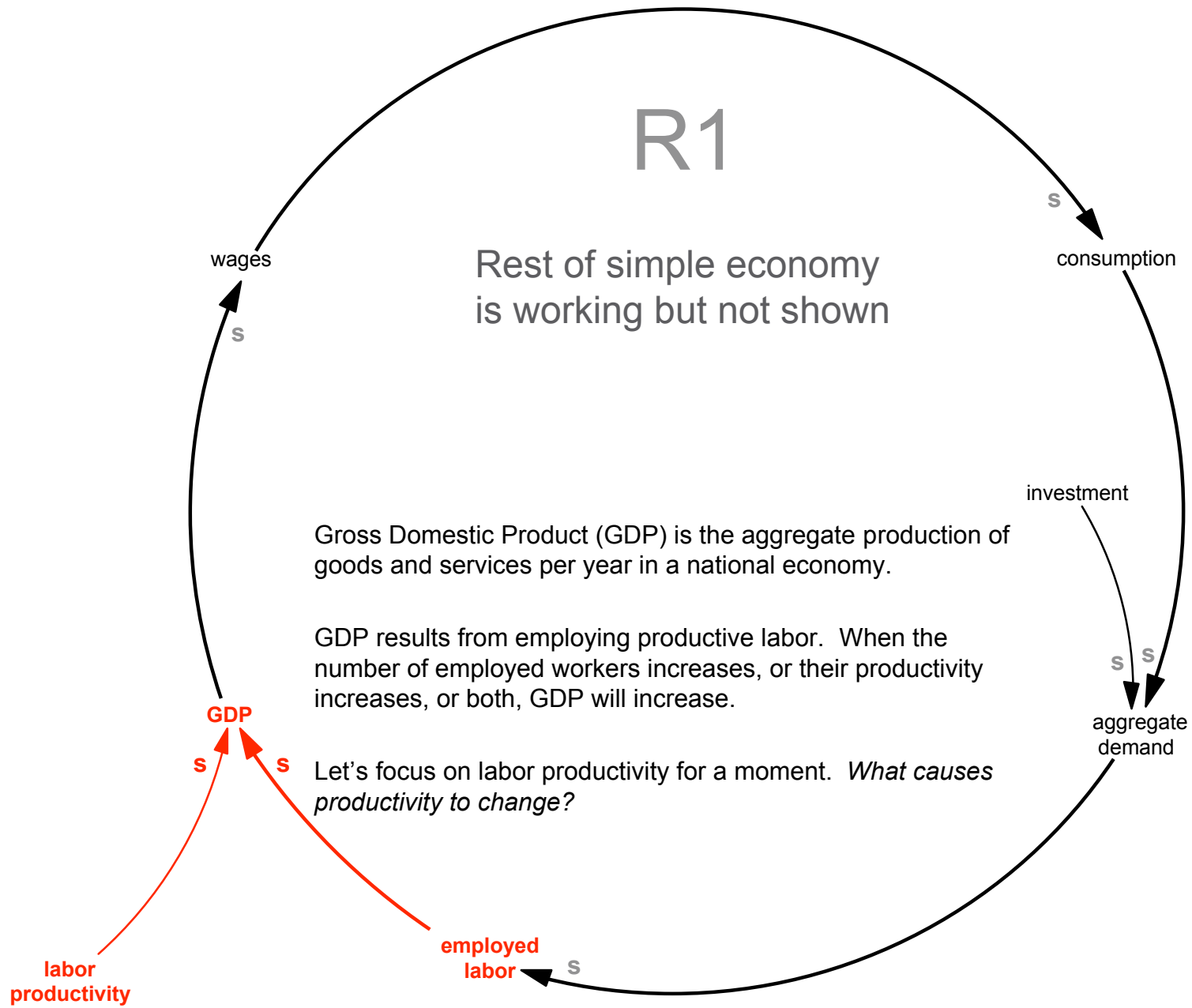
R1

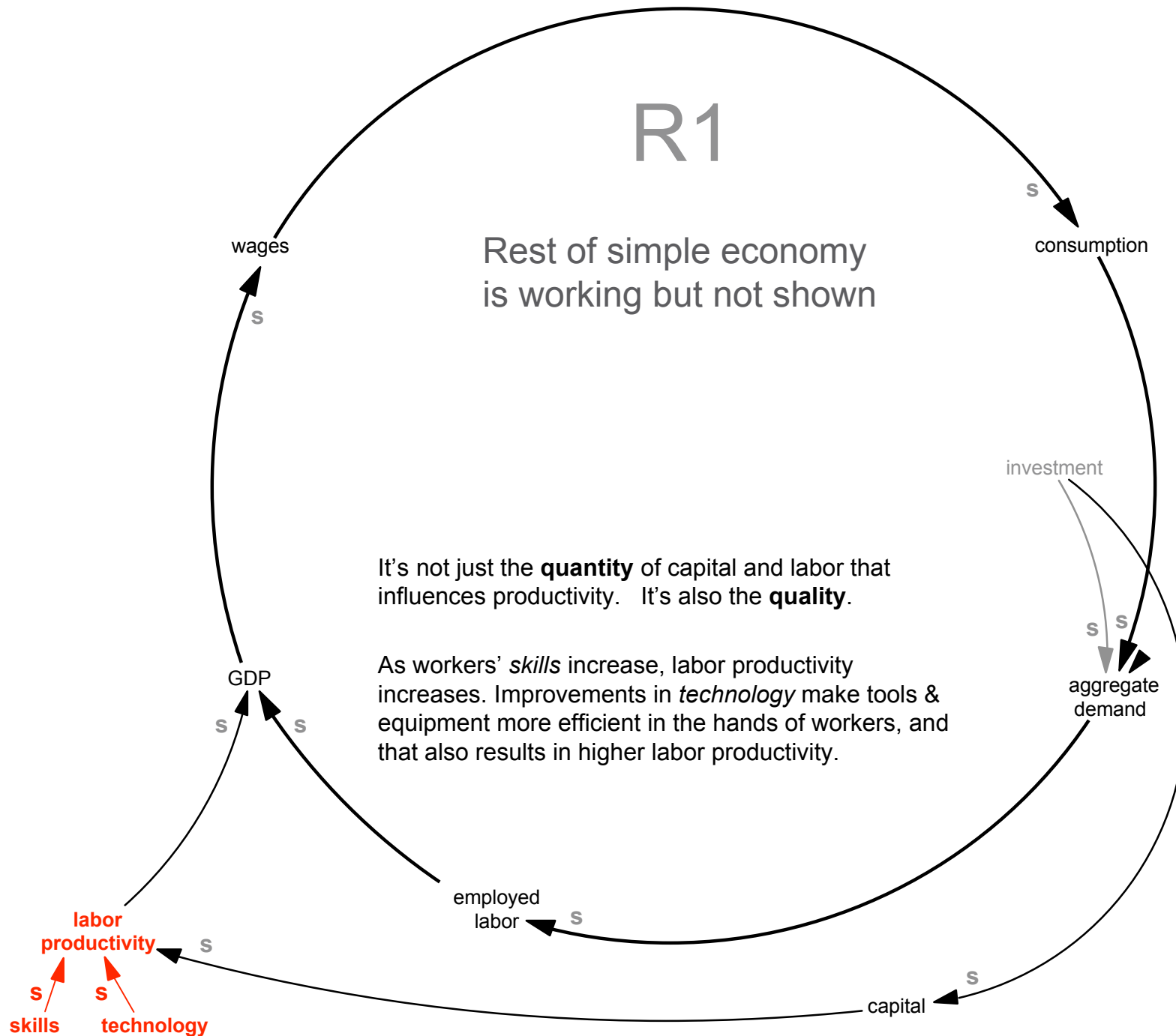
Rest of simple economy
is working but not shown

Here is the major reinforcing loop for economic growth
or decline that you saw in the Feedback story.

In that story, you also saw much of what is called the
“Supply Side” of the economy. We will briefly review
those parts and then introduce the rest.







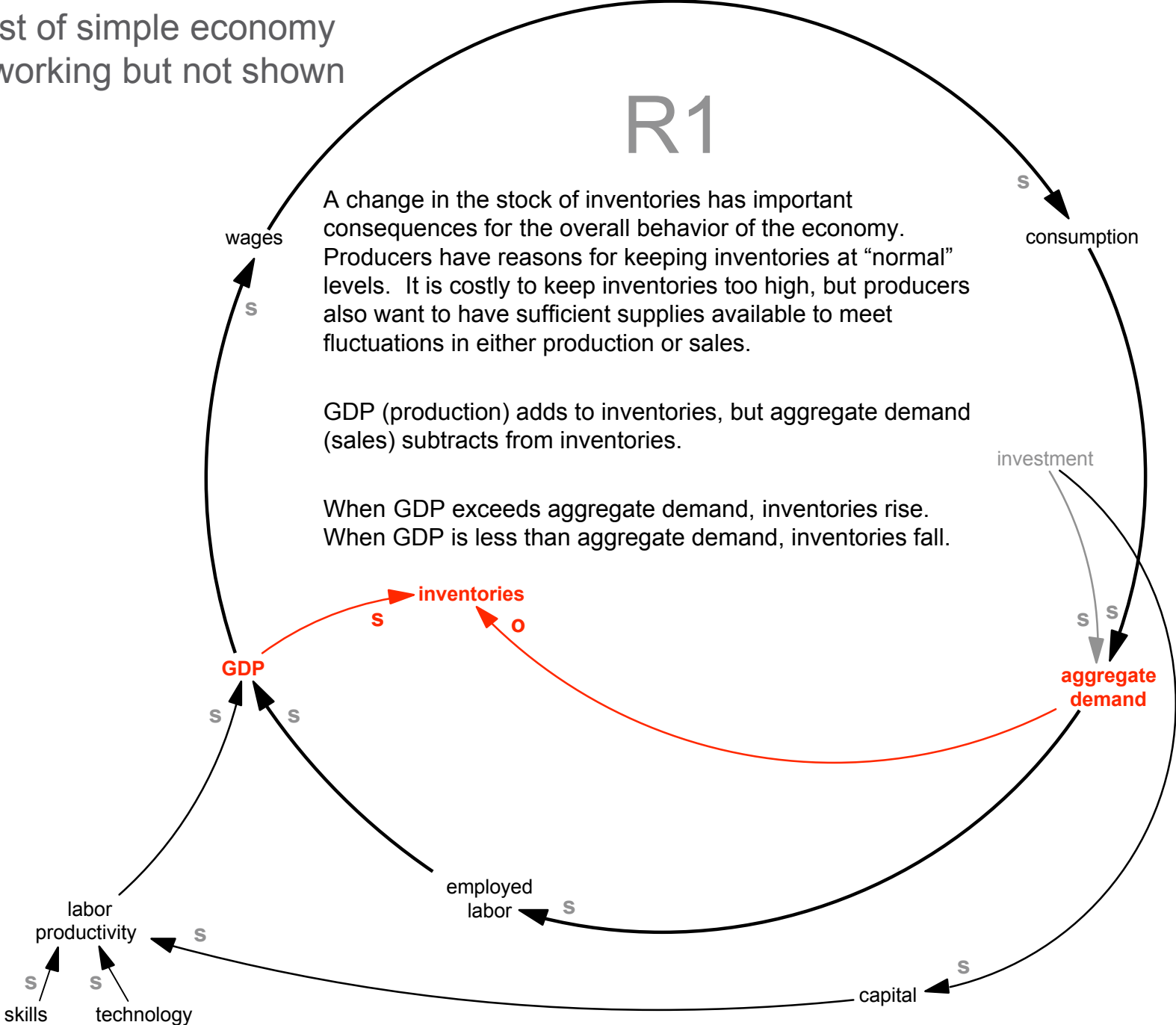
Rest of simple economy
is working but not shown

R1

A change in the stock of inventories has important consequences for the overall behavior of the economy. Producers have reasons for keeping inventories at “normal” levels. It is costly to keep inventories too high, but producers also want to have sufficient supplies available to meet fluctuations in either production or sales.

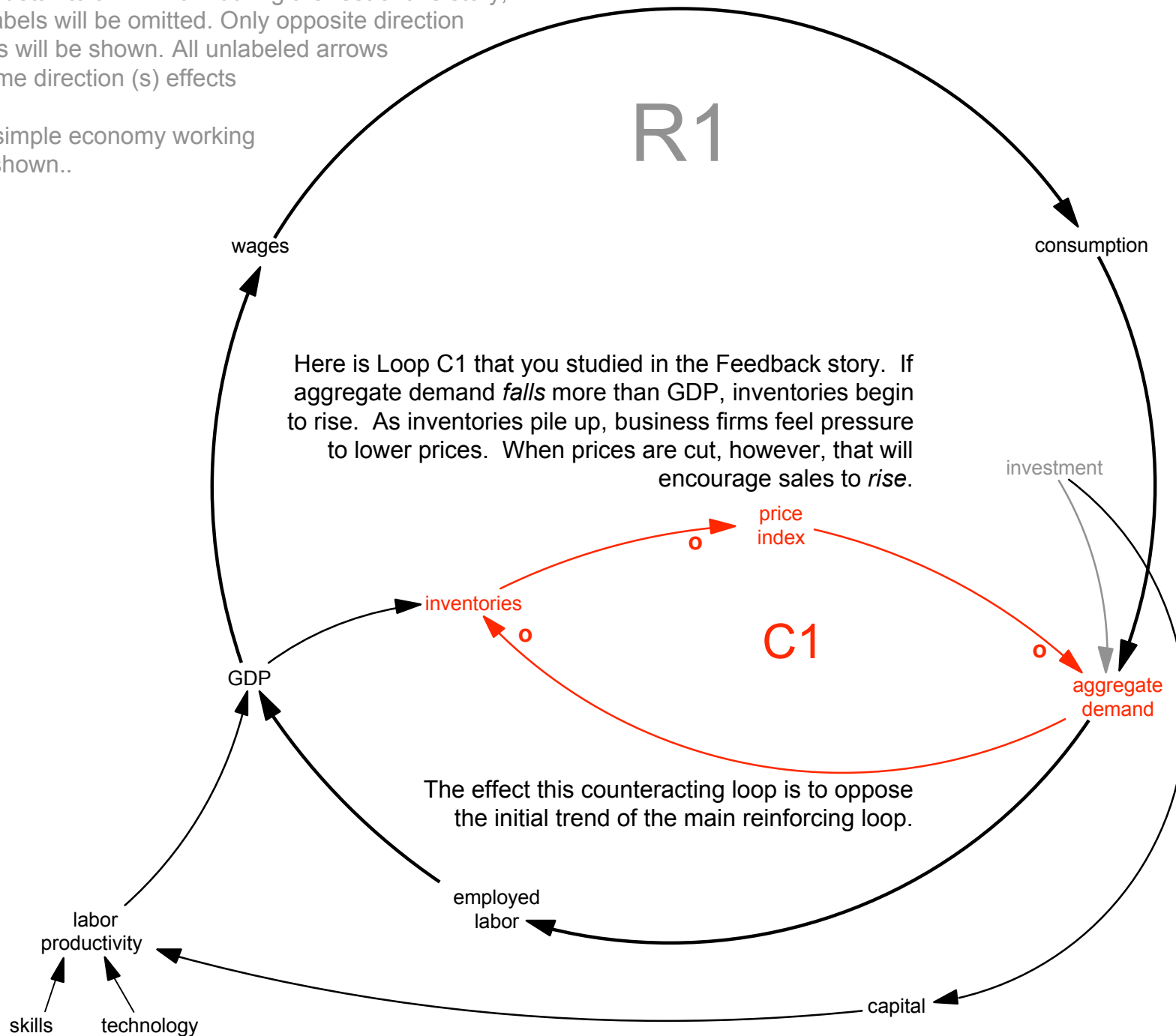
GDP (production) adds to inventories, but aggregate demand (sales) subtracts from inventories.

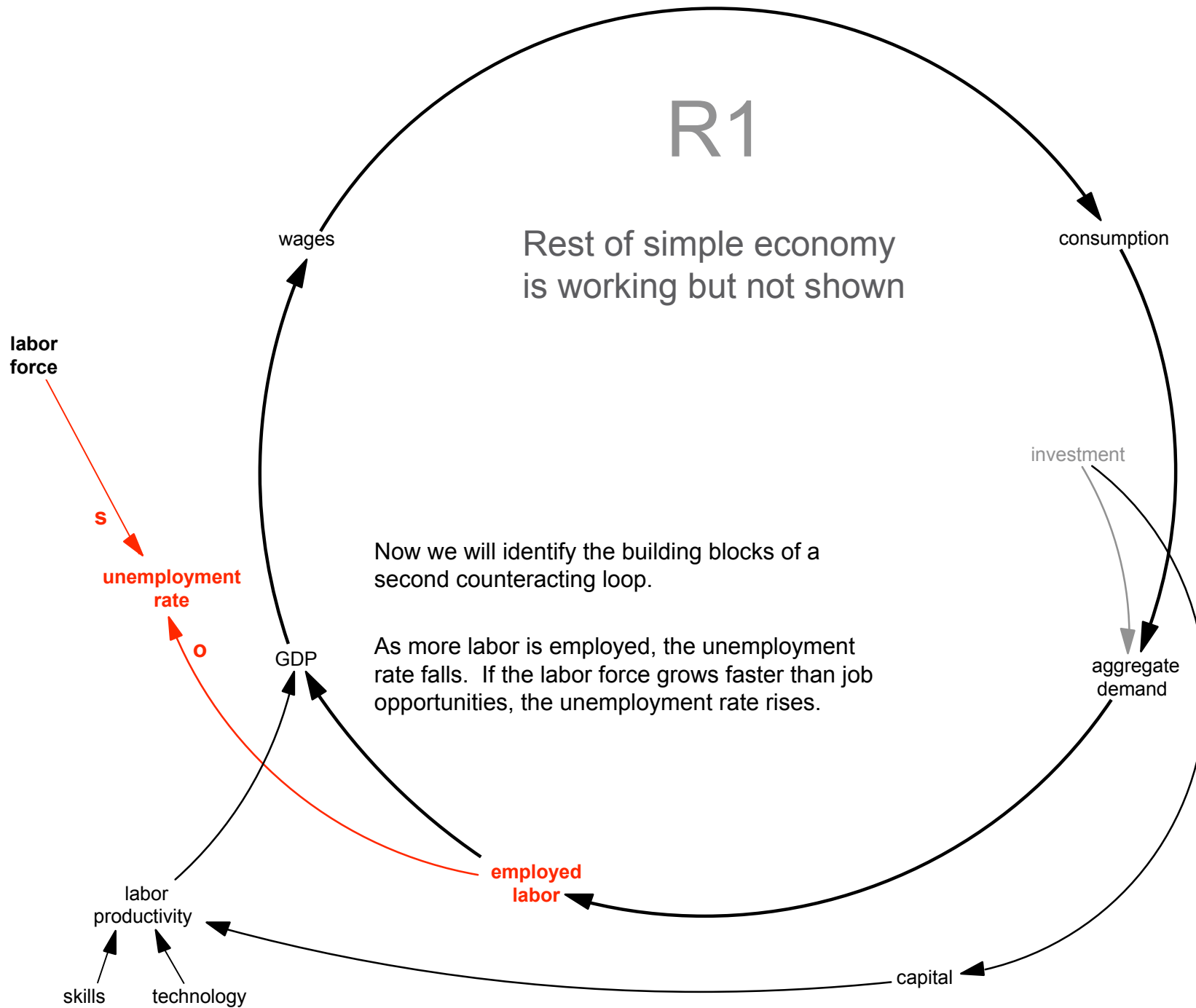
When GDP exceeds aggregate demand, inventories rise.
When GDP is less than aggregate demand, inventories fall.

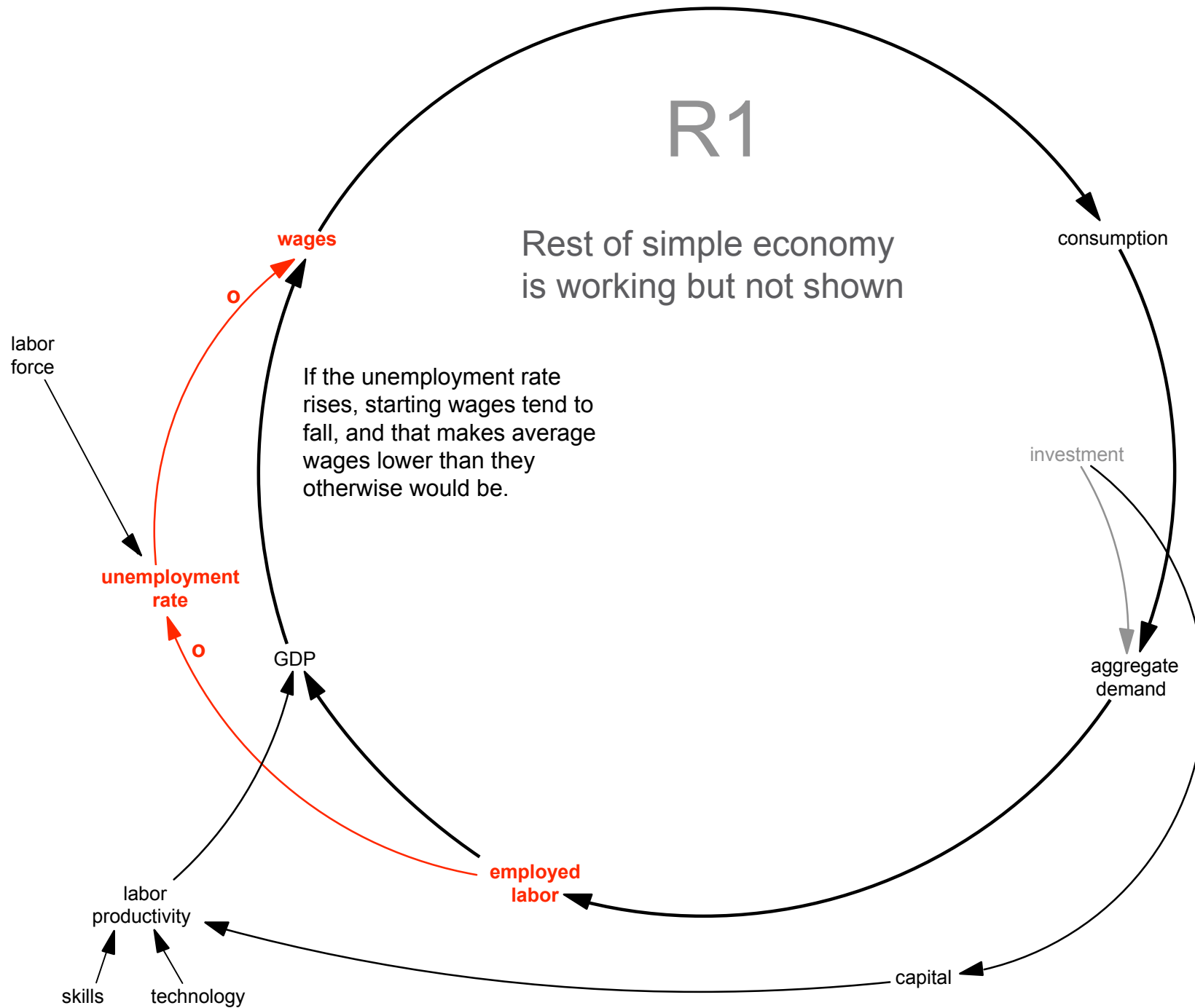


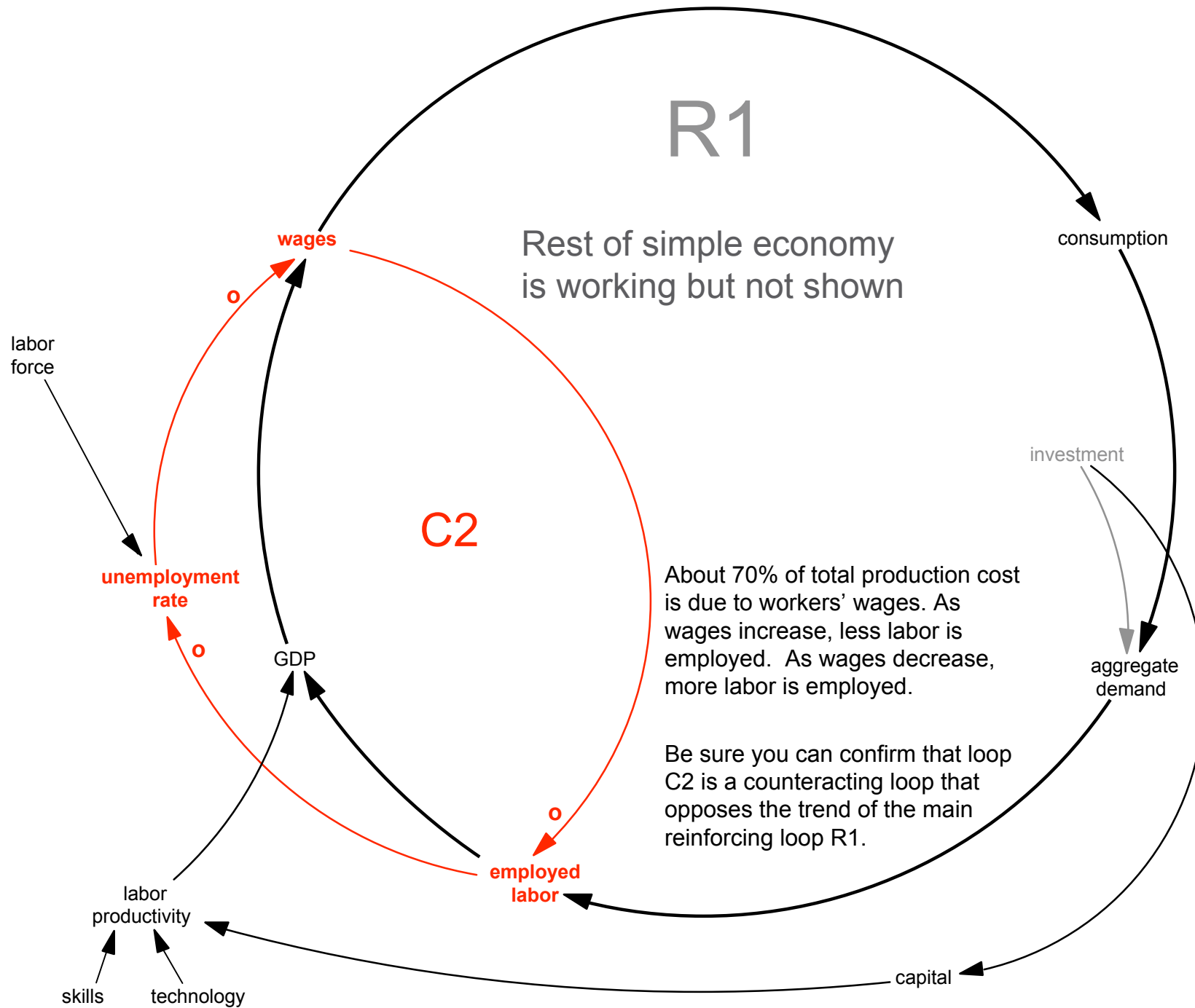
To keep detail to a minimum during the rest of this story, the “s” labels will be omitted. Only opposite direction (o) labels will be shown. All unlabeled arrows have same direction (s) effects

Rest of simple economy working but not shown..



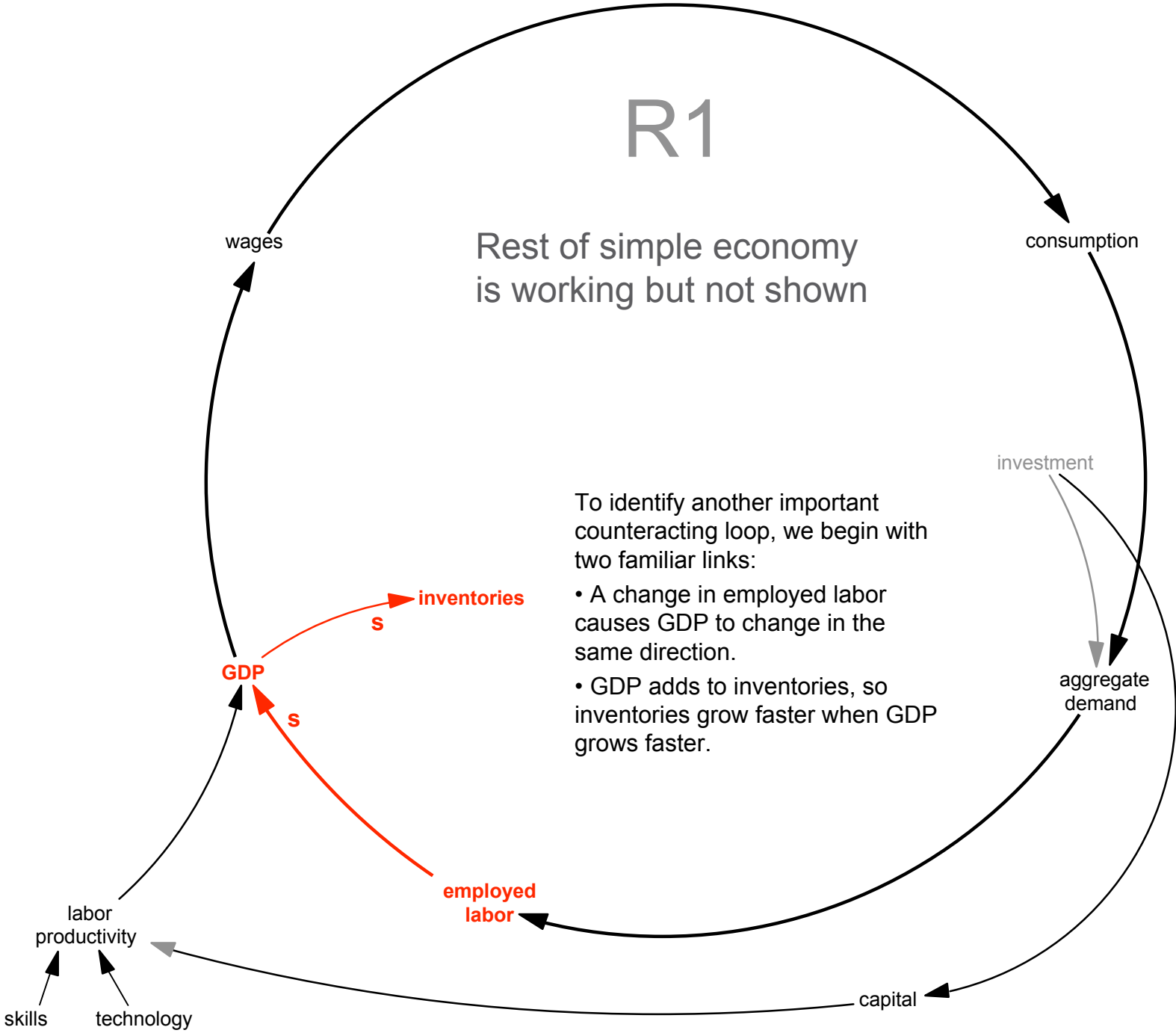




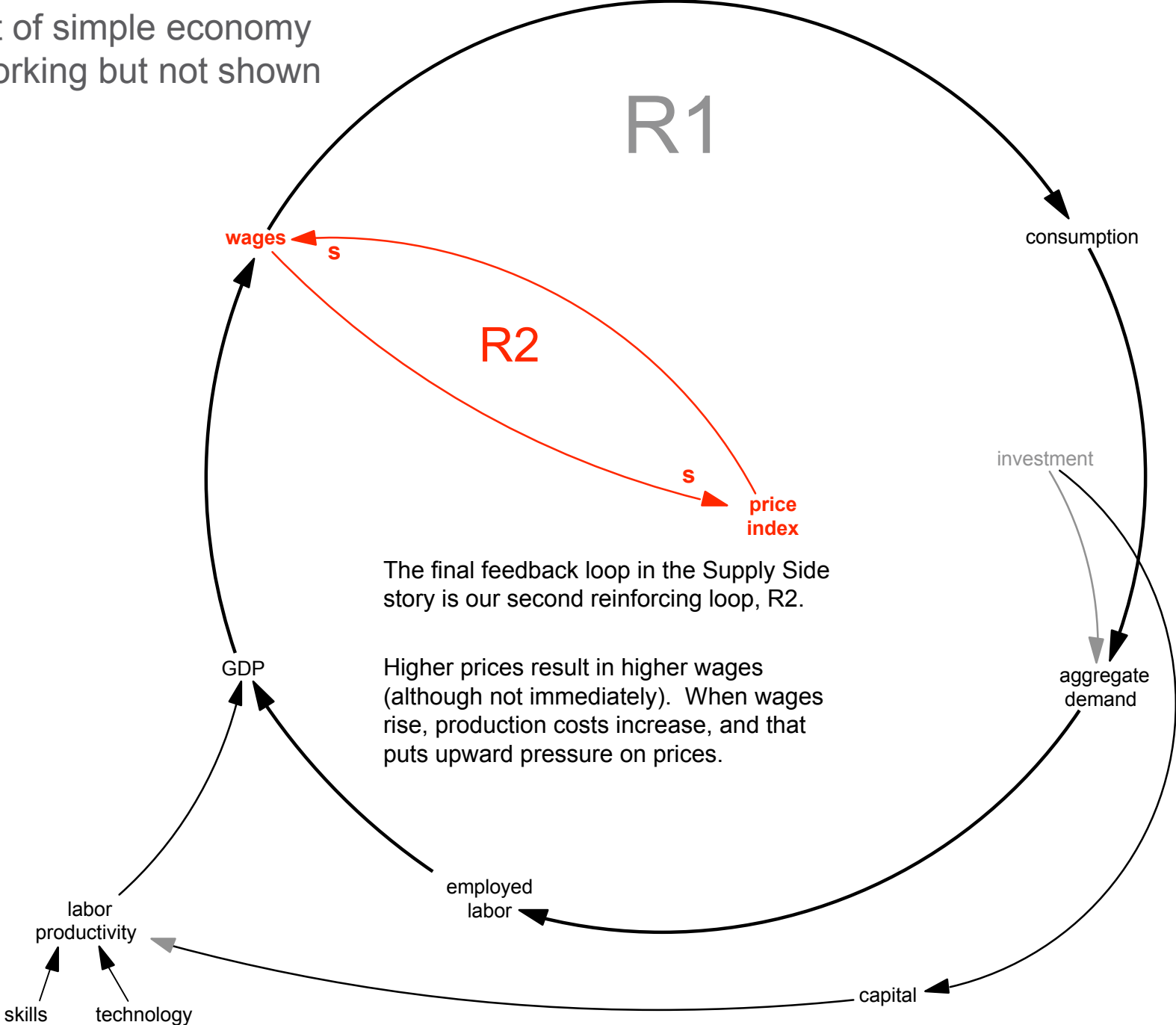


R1

Rest of simple economy
is working but not shown

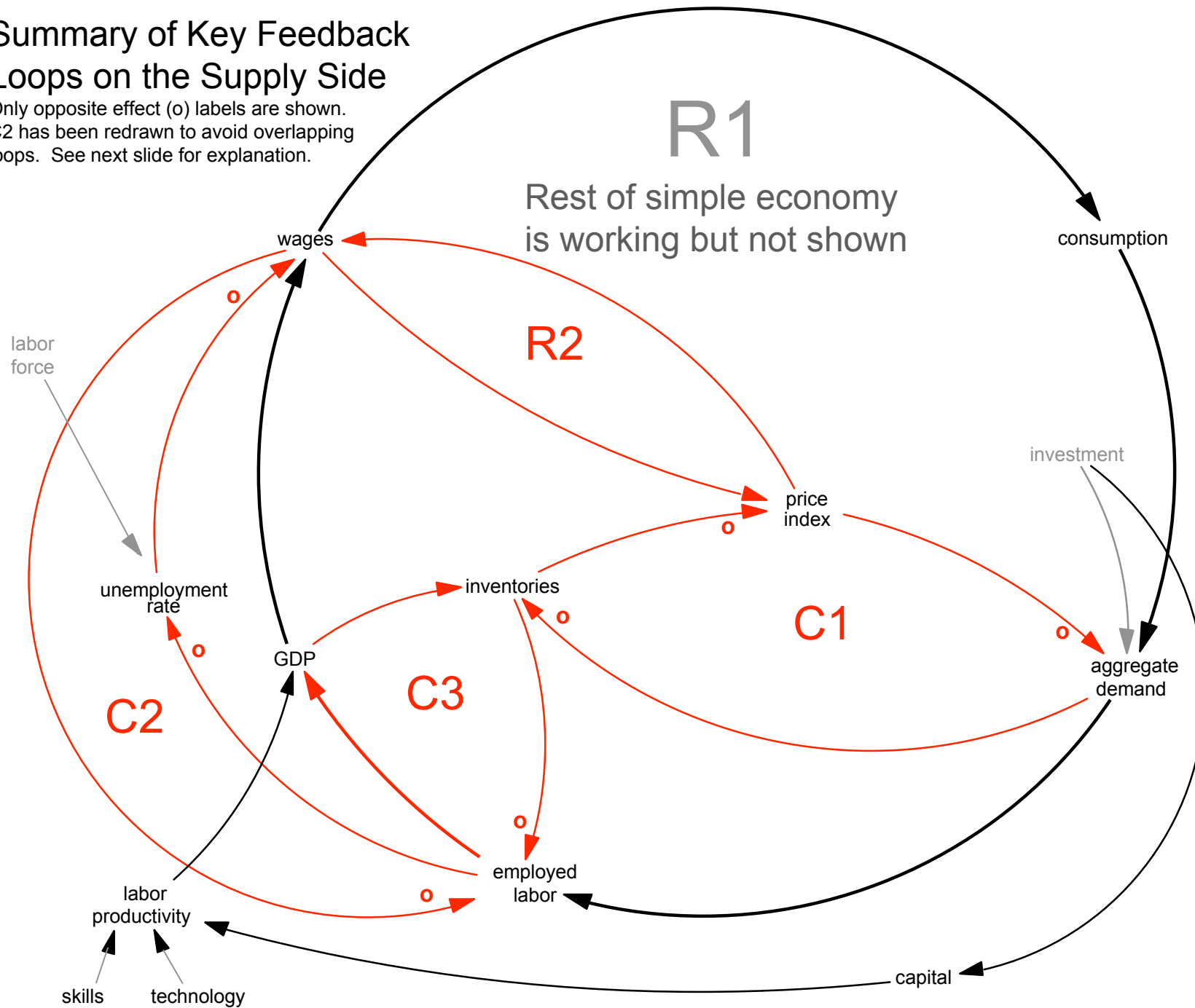


Rest of simple economy
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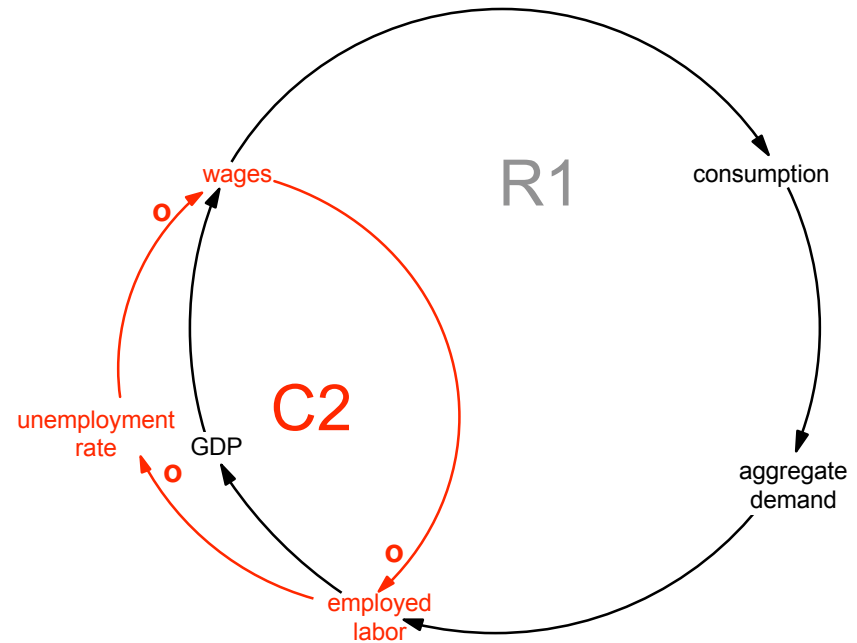


Summary of Key Feedback Loops on the Supply Side

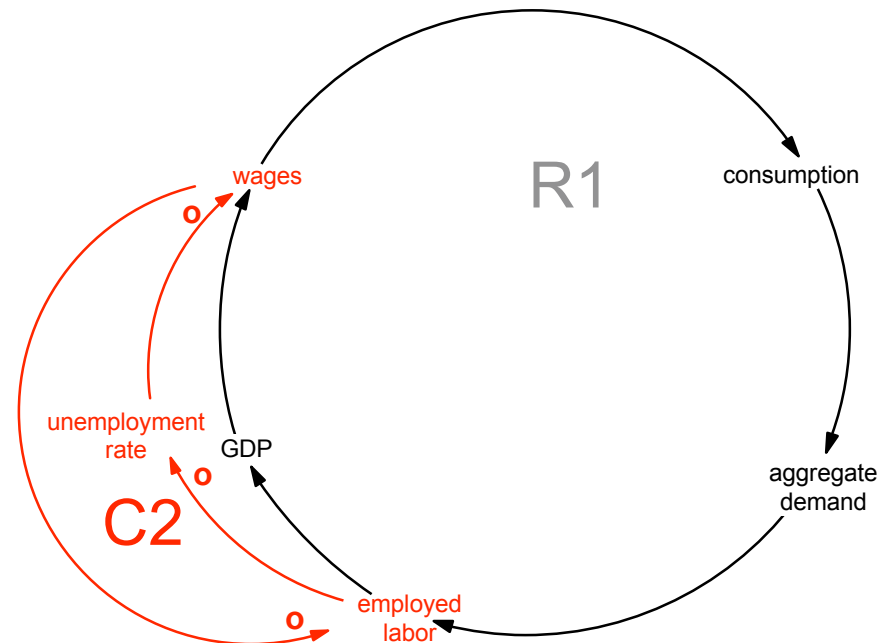
Only opposite effect (o) labels are shown.
C2 has been redrawn to avoid overlapping loops. See next slide for explanation.



This is how loop C2 was originally drawn, in order to emphasize the circular effect.



To avoid overlapping other loops, loop C2 was redrawn completely outside R1. The relationships are unchanged (three "opposite direction" effects), and the loop still opposes the trend of R1.



Summary

In this Supply Side story, you reviewed two feedback loops introduced in the Feedback Story:

- R1: main reinforcing loop
- C1: counteracting loop (aggregate demand, inventories, prices)

You also encountered three new loops:

- C2: counteracting loop (employed labor, unemployment rate, wages)
- C3: counteracting loop (GDP, inventories, employed labor)
- R2: reinforcing loop (wages and prices)

There are many other feedback loops affecting production decisions on the Supply Side of the economy, but these are particularly important.

In the next story, we will explore the Demand Side of the economy, where spending decisions are made.