CONCEPT: OVERVIEW OF THE NEW CLASSICAL MODEL

● The ***new classical model of economics*** has similar views to the *classical model* prior to the Great Depression

  □ Developed by Robert Lucas, Thomas Sargent, and Robert Barro in the 1970s

  □ Similarities to classical model:

    > Economy tends to be at potential GDP

      - Full employment and available resources are utilized

    > Wages and prices are _______________

      - Adjust quickly to changes in supply and demand

      - This is one of the main differences from Keynesian economics, which viewed prices as _________

  □ The new classical model builds on the original by including ***rational expectations***

    > Firms and workers form expectations about the future value of economic variables, like the inflation rate

    > If the actual inflation rate is different than the expected inflation rate, there are economic repercussions

      - See "Shifts in Short-Run Phillips Curve and Expected Inflation"

    > The new classical theory agrees with the monetarist model that a monetary growth rule should be used

      - In this case, a steady growth rule makes it easier for firms and workers to make expectations