Optional Assignment #4

1. The "tennis racket" events are the: bursting of speculative stock bubbles; spike in energy prices; terrorist attacks; collapses of Enron and Argentina. The major implication about the cycle mechanism is that the economy's cycle mechanism has become more muted. This suggestion implies a shallower business cycle—regardless of the source of the disturbance.

2. The events seem to fit the real business cycle theory best because the discussion covers the role of technological innovations as factors that lead to fluctuations in economic growth.

These were relatively straightforward questions, but only the very best answers got full credit.

Here are some excepts from good answers:

1. "The "tennis racket" analogy is saying that the racket is an outside force and that each time it is applied, the ball (or status of the economy) changes direction (Parkin 336). As such, the shocks the author speaks of represent "tennis rackets": the stock bubble bursting, the spike in energy prices, the terrorist attacks of 9/11, and the collapse of Enron and Argentina. All these represent outside forces that would normally change direction of the economy (the ball). What the author is saying, however, is that the economy's cycle mechanism is less based on outside forces. The author's analysis on the U.S. economy "escap[ing] with only a mild recession" alters the tennis ball cycle analogy in that the ball is absorbing a lot of the force from the racket and consequently doesn't change direction as easily from the racket. According to the author, the economy has become more flexible and the business cycle can be "tamed" by business executives and economic officials—the ball's direction and speed can now be more easily controlled."

"The idea of the tennis racket is that the ball (economy) moves back and forth (i.e., from recession to expansion) based on being hit by tennis rackets on each side (shocks to the economy). Thus the various shocks described—bursting of the tech stock bubble, spike in energy prices, terrorist attacks, and collapse of Latin American economies—are like tennis rackets influencing the economy. The change the author refers to could be further analogized as the tennis racket being strung more loosely so that each hit/shock has less effect. That is, the economy has become more able to absorb these shocks without a big effect on production."

2. "Real Business Cycle Theory best fits the series of events in the quote. RBC Theory is an aggregate supply theory that coincides with the quote's analysis of higher growth periods accompanying growth in aggregate supply, caused by productivity improvements and the like. The RBC Theory's impulse of productivity shocks and its mechanism of investment => LAS (long-run aggregate supply curve) again fits with the quote's explanations of productivity improvements' impacts. Just as RBC Theory tells us, the quote implies that we see fluctuations in potential GDP (linked to the classical *dichotomy). RBC Theory is particularly defended in this quote's context because of the unpredictable nature of economic expansion alluded to in the quote…The last part of the quote makes sense in the context of the RBC Theory's implicit contention that unemployment is always at its natural rate."*

"The series of events best fits the real business cycle model. The impulses of economic fluctuations are productivity shocks driven by technological change. The changes in productivity affect long-run aggregate supply through investment and capital accumulation. In this model the economy is always at potential and unemployment equals the natural rate. Cycle fluctuations are not driven by nominal things (i.e., money), but through real factors (i.e., technology change)."