

A Multi-model Analysis of Infrastructure-led Growth and Inflation Control in Taiwan and Government Experience in Macroeconomic Decision-Making

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Abstract. This study examines the macroeconomic impact of Taiwan's Ten Major Construction Projects (1974–1979) through the AD–AS, IS–LM, and MP–PC models. The programme was launched to ease transport congestion, reduce energy shortages, and improve infrastructure. The results show that the projects shifted both aggregate demand (AD) and aggregate supply (AS) to the right. Specifically, demand increased through enhanced investment, greater export competitiveness, higher income and consumption, and was reinforced by the multiplier effect. At the same time, supply expanded as improvements in transport, energy, and technology raised productivity and the aggregate production function. In the IS–LM model, the IS curve shifted rightward, while the LM curve remained fixed. The increase in money demand triggered fiscal expansion, which raised output but also pushed up nominal interest rates. In the MP–PC model, both MP and PC curve shifted upward, illustrating how inflationary pressures led to tighter monetary policy.

Keywords: Aggregate Demand, Aggregate Supply, Inflation, Interest Rate, Monetary Policy, Supply-side Policy.

1. Introduction

In the early 1970s, Taiwan's infrastructure was far behind its rapid economic growth. Transport delays were common, railway and highway congestion could slow travel by up to 50%, and electricity shortages often occurred [1]. The situation became more pressing after the 1973 oil crisis, which exposed Taiwan's heavy reliance on imported energy and raw materials. Industrial demand was outpacing infrastructure capacity, putting serious strain on transport and power systems and threatening future growth.

To tackle these problems, the government launched the **Ten Major Construction Projects** in 1974. This large-scale program aimed to ease transport bottlenecks, expand heavy industry, and build a nuclear power plant to strengthen energy security. These investments modernised Taiwan's transport, energy, and industrial base, while also driving major shifts in aggregate demand (AD) and aggregate supply (AS), reshaping the overall economy.

Unlike in traditional economic models, where assumptions can be predetermined, policymakers must confront trade-offs and prioritise the most pressing issues. At the end of the 1970s, Taiwan's economic authorities faced a choice between maintaining economic growth and controlling inflation. Concerned about overheating and the risk of speculative bubbles, they opted to prioritise inflation control, reflecting the principle that decision-making should be guided by the desired long-term outcome.

This study aims to analyze that “The changes in AD and AS resulting from Taiwan's Ten Major Construction Projects transmitted through the IS-LM and MP-PC frameworks providing insights into Taiwan's monetary policy and output dynamics in the late 1970s .”Analysing this episode provides an important historical example of how large infrastructure programs impact monetary policy, and thus an important lesson about how monetary policy may affect both growth and inflation during the process of industrialisation. A full appreciation of the claim above requires an interpretation of AD–AS shifts using the IS-LM framework first and then interpreting these results by analysing how monetary policy affects inflation and output using the MP-PC model. This allows us to see how the

transmission mechanism linking the infrastructure investment, macroeconomic policy and economic performance works.

2. Theoretical background

2.1. AD-AS model

The aggregate demand–aggregate supply (AD–AS) framework has become a standard tool in macroeconomics for explaining fluctuations in output and the price level. Originating in the late 1940s and early 1950s, with early contributions from O.H. Brownlee and Kenneth Boulding, the model gradually developed into one of the most widely adopted teaching and analytical devices in macroeconomics [2]. While more recent developments in macroeconomic theory have favoured dynamic stochastic general equilibrium (DSGE) models, the static AD–AS framework continues to be valued for its simplicity, accessibility, and clarity.

In its static form, the AD–AS model shows us how aggregate demand and aggregate supply relate in an output–price form. Aggregate demand (AD) is made up of household consumption (C), private investment (I), government spending (G) and net exports (X–M). It slopes downward, reflecting the inverse relationship between the general price level and real output demanded. Aggregate demand therefore may shift due to changes in money, fiscal policy or trade.

On the supply side, the model distinguishes between the short run and the long run. In the short run, wages and other input costs are slow to adjust, which gives the short-run aggregate supply (SRAS) curve an upward slope, or in the extreme case of completely fixed prices, a horizontal shape. This reflects the idea that firms can expand production in response to demand shocks without facing immediate increases in costs, since unused capacity and unemployment allow output to rise without additional cost pressures. In contrast, the long-run aggregate supply (LRAS) curve is vertical, reflecting the economy’s structural or “natural” level of output. Long-run output is determined by factors such as the capital stock, labour force, human capital, and technology. Over time, wages and prices are assumed to adjust fully, eliminating the impact of demand shocks on real variables.

Existing literature has applied the AD–AS framework to both the supply and demand sides of infrastructure investment. On the supply side, road construction projects require large inputs and careful logistics, and that improving efficiency in material supply can lower the production cost, thereby shifting the aggregate supply rightward [3]. On the demand side, scholar reviews evidence on the economic effects of transport infrastructure, showing that such projects boost spending during construction, create jobs, and raise incomes, which in turn stimulate consumption and investment [4]. Improved connectivity further enhances market access and trade, reinforcing aggregate demand. Similarly, another research applied the AD–AS framework to Taiwan’s Ten Major Construction Projects, arguing that large-scale public investments provided necessary support during a period of economic slowdown by offsetting reduced private investment and sustaining short-run demand [5]. The research further emphasised that the projects not only mitigated immediate economic weakness but also reinforced business confidence, laying the foundation for development initiatives in the following decade.

Nonetheless, there are always limitations in the AD-AS framework. Scholars have pointed out it lacks firm microeconomic foundations, relying on simplified behavioural rules rather than optimisation. The model is essentially static, offering little insight into adjustment dynamics, expectation formation, or stability over time. In addition, its assumption that wages and prices will eventually adjust to bring about balance ignores Keynes’s criticism that flexible wages might not lead, automatically, to balance. Despite these weaknesses, the AD–AS framework remains a useful tool for illustrating the interaction of demand and supply forces and for assessing the effects of policy interventions and large-scale public investments [6].

2.2. IS-LM model

The IS–LM framework has been one of the most influential tools in the post-war macroeconomic analysis. The model describes the interaction between the goods and services market, as well as the money market. The model also presents the short-run equilibrium in output and interest rates. On the fiscal side, the IS curve is downward sloping, which reflects the negative relationship between interest rates and output. The lower interest rates stimulate investment and thus aggregate demand, hence raises income. On the monetary side, the LM curve is upward sloping, because higher income raises the demand for transactions balances, which pushes up interest rates given a fixed money supply. The intersection of the IS and LM curves defines short-run equilibrium output and interest rates, providing a framework to analyse how fiscal and monetary policies influence national income under fixed price levels.

Empirical examples further underlined the IS–LM’s role. In the 1950s and 1960s, it provided the foundation of large-scale macro econometric models such as the MIT–Penn–SSRC (MPS) model and the Data Resources Inc. (DRI) model in the United States, which later were widely used for forecasting and policy evaluation [7]. Specifically, they are used to analyse how fiscal spending and monetary policy affected both output and interest rates, and how to conduct evidence-based policy making. These frameworks were particularly useful in the infrastructure investment, where the fiscal expansion shifted the IS curve rightward, raising output and employment, while the slope of the LM curve determined the extent to which public investment crowded in or crowded out private activity. Later contributions stressed adapting the framework to modern monetary practice, where central banks set interest rates directly according to the value of short run equilibrium that provided by the IS-LM model [8] [9]. For infrastructure policy, this means the impact of government spending depends on whether monetary policy accommodates the fiscal impulse or offsets it with higher rates.

However, the IS–LM model faces several limitations. First, the framework abstracts from the supply side of the economy, making it poorly suited to analyse price-level movements of simultaneous inflation and stagnation [7]. Second, its assumption of an exogenous money supply has become increasingly unrealistic, as modern central bank target interest rates rather than monetary aggregates [8] [9]. Third, empirical evaluations indicate that IS–LM-based policy prescriptions often proved unreliable in periods of structural instability or financial innovation, when the relationships between money, output, and interest rates shifted unpredictably. Although “second-generation” versions of the model introduced rational expectations and micro foundations, the traditional IS–LM framework today is regarded mainly as a heuristic and teaching device rather than a tool for robust policy design.

2.3. MP-PC model

The MP–PC framework, often combined with an IS curve to form the three-equation New Keynesian model, has become a central tool in modern macroeconomic analysis. Developed in the 1990s and 2000s as part of the “New Consensus” in macroeconomics, it integrates a monetary policy rule with the Phillips Curve to explain short-run fluctuations and the transmission of policy to output and inflation [8]. The model is widely regarded as a more realistic successor to the traditional IS–LM framework, reflecting the shift in central banking practice from targeting money supply to targeting short-term interest rates, alongside the renewed focus on inflation dynamics.

In this framework, the LM curve is replaced by a monetary policy (MP) curve that captures the central bank’s interest rate–setting behaviour. Rather than assuming that monetary policy operates through exogenous control of the money supply, the MP curve reflects the modern practice of targeting the short-term interest rate directly, often according to a rule similar to the Taylor rule. On the supply side, the model incorporates a short-run Phillips Curve (PC), which captures the relationship between inflation and the output gap (or unemployment gap). This setup highlights how expectations about future inflation and demand conditions influence current inflation, which makes the model particularly important for studying stabilisation policies under inflation-targeting frameworks.

Existing literature has applied the MP–PC framework to both theoretical and empirical settings. Researchers used the IS–MP–PC structure to study Korea, finding that exchange rate movements and inflation expectations significantly influenced output [10]. Another research extended the model in the Nigerian context by incorporating net export gains, showing that output responded negatively to exchange rate appreciation, government deficit spending, and expected inflation, while positively to trade performance and global interest rates [11]. These studies illustrate that infrastructure and fiscal spending can stimulate demand, but their effectiveness is mediated by the monetary policy stance and by how inflation expectations adjust.

However, the MP–PC model also faces limitations. Critics argue that its reliance on a simple Phillips Curve may not adequately capture non-linearities or structural changes in inflation dynamics, especially in emerging economies. Similarly, the Taylor-rule specification of the MP curve may oversimplify actual central bank behaviour, particularly during crises when unconventional policies are employed. Despite these weaknesses, the MP–PC framework remains an influential tool for examining how infrastructure-led fiscal expansions interact with monetary rules and expectations to shape short-run output and inflation.

3. The application of models in Taiwan

The 1970s represented a turning point in Taiwan's political economy, marked by both external shocks and domestic transformation. Internationally, Taiwan's withdrawal from the United Nations in 1971 reduced Taiwan's participation in global decision-making bodies and multilateral organizations, restricting its ability to influence international trade, security, and development agendas. Due to this diplomatic shift, numerous formal allies were destroyed. Suppressing Taiwan's political support and access to foreign markets. Economic vulnerability, particularly, was challenged due to growing global isolation. Given Taiwan's dependence on foreign investment, export markets, and manufactured energy.

Economically, the first oil crisis of 1973 exposed Taiwan's dependence on imported energy, leading to higher production costs, surging inflation, and a contraction of industrial activity as firms faced rising input prices alongside weaker global demand. At the same time, the rapid export-led growth of the 1960s had revealed structural bottlenecks in infrastructure, transport, and heavy industries, including insufficient highway and port capacity and limited domestic production of steel and petrochemicals. These constraints revealed the limitations of a growth model dominated by labour-intensive light manufacturing such as textiles and consumer goods and highlighted the need for a transition toward capital- and technology-intensive industries, including steel, shipbuilding, petrochemicals, and electronics. In this context, it became increasingly necessary for the government to adopt a proactive developmental strategy aimed at upgrading industrial capacity, improving infrastructure, and safeguarding long-term economic resilience.

The Ten Major Construction Projects, launched in 1974 under Premier Chiang Ching-kuo, are widely regarded as one of Taiwan's most ambitious state-led infrastructure initiatives. Designed to promote industrial upgrading and national development while responding to the challenges of the 1973 oil crisis and Taiwan's diplomatic isolation, the program included six transportation projects (the North–South Freeway, electrification of the West Coast Line, the North-Link Line, Chiang Kai-shek International Airport, the Port of Taichung, and Su-ao Port), three industrial projects (a large shipyard, an integrated steel mill, and an oil refinery with industrial park facilities), and one energy project (the Jinshan Nuclear Power Plant). The total investment exceeded NT\$300 billion.

These projects played a central role in reshaping Taiwan's economy in the mid-1970s. Data from the Directorate-General of Budget, Accounting, and Statistics show that after the launch of National Freeway No. 1 in 1971, Taiwan's economy slowed: by 1974, GDP growth had fallen to 1.16%, industrial output contracted by 4.5%, and inflation surged to 47.5%. Within two years, however, the situation had reversed. By 1976, GDP growth had risen to 13.86%, industrial production expanded by 24.4%, and inflation had dropped to 2.48%. This turnaround has often been linked to the progress

generated by the Ten Major Construction Projects, which mitigated structural constraints and laid the foundations for renewed growth.

These three models provide complementary perspectives on the macroeconomic consequences of the Ten Major Construction Projects. The AD-AS framework highlights the interplay between short-term demand shocks and long-term productivity boost; the IS-LM model clarifies how fiscal policies interacted with monetary conditions; and the MP-PC framework focuses on the trade-off between inflation control and economic growth, as well as the central bank's policy reactions. Integrating these perspectives enables a more comprehensive understanding of how large-scale public investment shaped Taiwan's output and inflation trajectory in the late 1970s.

4. Results in three models

4.1. AD&AS Model

4.1.1 The Transmission Mechanism in the AD&AS Model

Between 1974 and 1984, Taiwan's government implemented the Ten Major Construction Projects, which illustrate how extensive infrastructure programmes can simultaneously stimulate aggregate demand (AD) and expand aggregate supply (AS). In the AD-AS model, these projects not only created short-term demand impulses but also enhanced long-term productive capacity, thereby driving Taiwan's structural transformation.

The AD-AS framework posits that the program operated through a dual impact mechanism. It not only stimulated aggregate demand in the short run but also enhanced the economy's long-run aggregate supply capacity, thereby influencing both price levels and total output. On the demand side, substantial increases in public expenditure, together with induced private investment, shifted the AD curve rightward, raising output and exerting upward pressure on prices in the short run. On the supply side, the completion of infrastructure elevated marginal product of labour and augmented aggregate production function, inducing a rightward shift of the long-run aggregate supply (LRAS) curve. Yet these supply-side gains materialized gradually, while in the short run, resource shortage and dependence on imported inputs, exacerbated by the global oil shocks, this may have shifted the short run Aggregates Supplies (SRAS) leftward, adding inflationary pressure. Literature on fiscal multipliers in developing economies suggests that such events often involve an initial inflation surge before supply-side improvements materialise.

4.1.2 Empirical Examples in the AD&AS Model

A salient example is the construction of the Sun Yat-sen Freeway (National Highway No. 1), the flagship of the Ten Major Projects. This major north-south artery significantly reduced travel times for both freight and commuters between key economic zones, enhancing the reliability and speed of goods delivery to ports and markets. For labour, the freeway improved commuting efficiency, facilitated greater labour mobility and enhanced job matching. For firms, it alleviated logistical frictions and elevated output per worker, thus increasing the marginal product of labour. This infrastructure investment acted as a complement to labour inputs, reinforcing the upward shift of the Long-Run Aggregate Supply (LRAS) curve.

Beyond domestic efficiency gains, the projects bolstered export competitiveness by reducing transportation and energy costs, thereby improving the international price competitiveness of Taiwanese goods, and facilitating a transition from import substitution to export-led industrialization. Ports in Taiwan were recognised by planners as critical infrastructure supporting economic growth. Even though the government operated them as monopolies, it sought to enhance their competitiveness against other regional ports. The expansion of facilities such as the Port of Kaohsiung positioned Taiwan as a strategic hub for Asia-Pacific trade, attracting transport companies and stimulating demand through increased trade flows.

The employment effects of the projects generated additional multiplier dynamics. Rising household incomes translated into greater consumption, setting in motion successive rounds of

expenditure and income generation. This Keynesian feedback mechanism amplified the demand-side impulse of the projects, sustaining aggregate expansion.

The expansion of Taichung Port, completed in 1976, illustrates the mechanisms at work. By reducing transport distance and alleviating congestion, the port lowered transaction costs associated with shipping and customs for firms in central Taiwan. Improved supply chain reliability allowed producers to minimize stockouts, bottlenecks, and shipping delays, while fostering industrial agglomeration around the adjacent Taichung Industrial Park. This integration of regional industries into global trade networks reinforced export competitiveness and contributed to both the rightward shift of the AD curve and the durability of the projects' long-run effects.

4.1.3 Results in the AD&AS Model

The results show that infrastructure development shifted both aggregate supply (AS) and aggregate demand (AD) to the right. On the supply side, productivity rose as better transportation, stronger regional connections, and faster diffusion of knowledge and technology increased the marginal product of labour and improved the production function. On the demand side, investment expanded with improved infrastructure, lower trade costs boosted exports, and rising wages and employment raised household income and consumption. These effects were reinforced by the multiplier effect, meaning that infrastructure projects not only raised potential output but also stimulated stronger demand, creating a dual impact that supported both short-term growth and long-term development.

4.2. IS-LM Model

4.2.1 The Transmission Mechanism in the IS-LM Framework

The IS-LM model explains equilibrium in the goods and services market and money markets. In the context of 1970s Taiwan, the Ten Major Construction Projects acted as a fiscal expansion, shifting the IS curve rightward via higher government spending and investment. This increased output, and without accommodated monetary policies, along with raised interest rates, potentially crowding out private investment. The magnitude of this crowding-out effect was contingent upon the slope of the LM curve, reflecting the degree of monetary accommodation. Historical evidence suggested that the central bank balanced inflation containment and growth promotion, with monetary tightening shifting the LM curve leftward, decreasing economic gains but easing inflationary pressure [11].

Moreover, these infrastructure investments enhanced productivity and increased the economy's long-run supply capacity. By raising factor productivity and expanding the aggregate production frontier, the projects induced a rightward shift of the aggregate supply (AS) curve, thereby increasing the long-run equilibrium level of output. In the IS-LM framework, this implies a higher potential income level, reinforcing the rightward shifts of the IS curve through improved investment incentives and strengthened expectations of future growth. This structural improvement reinforces the upward pressure on interest rates unless matched by a corresponding expansion of the money supply. Because greater investment opportunities and higher expected returns increase the demand for loanable funds. If the central bank does not increase the money supply to accommodate this higher demand for liquidity, the competition for available funds will push interest rates upward, which could partly offset the investment stimulus.

4.2.2 Results in the IS-LM Framework

Within the IS-LM framework, the transmission mechanism of the Ten Major Construction Projects operated primarily through an expansion of aggregate demand. Increases in consumption (C), investment (I), government expenditure (G), and net exports (X-M) generated a rightward shift of the aggregate demand (AD) curve [13]. This expansion in demand raised equilibrium output in the goods market and is reflected in the IS-LM framework as a rightward displacement of the IS curve [14]. The increase in output simultaneously heightened the demand for money, thereby exerting upward pressure on interest rates in the absence of a corresponding monetary expansion. In the short run, the LM curve remained relatively fixed, suggesting that unless the central bank expanded the money supply, interest rates rose as a natural consequence of higher money demand.

4.3. The Transmission Mechanism in the MP-PC Framework

The MP-PC framework synthesizes the monetary policy reaction function with the expectations-augmented Phillips Curve, thereby capturing the interaction between central bank behavior and short-run inflation–output dynamics. The MP curve reflects the central bank’s adjustment of the real interest rate in response to deviations of inflation from target and output from potential, while the PC shows the short-run trade-off between inflation and the output gap. The demand expansion from the Ten Major Construction Projects likely created a positive output gap, placing upward pressure on inflation. If the central bank responded by raising interest rates, the economy would have moved along the Phillips Curve toward lower output but reduced inflation pressure. Alternatively, suffering higher inflation to sustain strategic investment would have eliminated the interest rate response, allowing inflation to persist. Although Taiwan’s central bank did not formally implement a Taylor-type rule in the 1970s, the MP-PC framework offers a structured lens for inferring its implicit policies and evaluating its influence on inflation–output dynamics.

With in the MP–PC framework, the fiscal expansion associated with the Ten Major Construction Projects operated through a rise in aggregate demand. The rightward shift of the IS curve increased both output and inflationary pressures. In response, the central bank raised the nominal interest rate, which is represented in the model as an upward shift of the monetary policy (MP) curve. Concurrently, the Phillips Curve (PC) shifted upward, reflecting two distinct sources of inflationary pressure: demand-pull inflation, generated by sustained increases in aggregate demand, and cost-push inflation, arising from temporary supply bottlenecks and adverse external shocks, most notably the oil crises of the 1970s.

5. Policy Conflict and Recommendations

The analysis across the three frameworks highlights a fundamental policy conflict. Significant increases in aggregate demand were also made by the Ten Major Construction Projects, resulting in long-term productive power increases and use (via increased funding, federal spending, and net exports). However, in the long run, demand-side results predominated, causing expansionary pressures that necessitated monetary tightening. Governmental growth, in contrast to the IS–LM model, increased production while putting downward pressure on interest costs. In the MP–PC model, the central bank increased nominal interest rates in response to increasing productivity and inflation, elevating the MP slope. While this reaction lowered inflation and controlled output growth and personal investment. Thus, it is obvious that monetary policy pursued caution while fiscal policy pursued growth.

Policy Recommendations

1. Improved fiscal-monetary coordination: The trade-off could have been lessened with a more coherent economic platform. Governmental expansion was necessary to address system bottlenecks. However, monetary policy could have been more accommodating in the long run, especially if supply-side measures had been used to counteract inflationary pressure.

2. Stratified purchase strategy: Astounding infrastructure projects over a longer time frame might have lowered inflationary pressure while generating long-term supply-side benefits. A gradual approach would have reduced the problem for economic officials to prevent burning.

3. Generally tightening monetary policy attitude: The central banks could have distinguished between the demand-pull and cost-push pieces rather than responding by tightening in response to higher prices. While stabilizing expectations, allowing temporary cost-push inflation to pass through did not excessively stifle expense and output.

4. Strengthening supply-side reforms: Supporting technological implementation, reducing type bottlenecks, and liberalizing industry would have helped change the AS slope more swiftly, reducing the inflationary effect of demand expansion.

5. Development of institutions: The encounter emphasizes creating crystal-clear plan frameworks, such as a distinct monetary policy concept or medium-term fiscal planning, to lessen uncertainty and maintain consistency between growth goals and price stability.

6. Conclusion

Aggregate Demand (AD) and Aggregate Supply (AS) were significantly boosted by implementing large-scale infrastructure projects, contributing to economic growth. Increased federal spending increased AD, forcing the IS curve to the right, increasing production and prices. The central bank increased interest rates to reduce inflation, leading to an upward revision of the MP-PC model's MP slope, indicating a tighter financial scheme.

The Phillips Curve (PC) rose up at the same time. This was due to cost push inflation, caused by increasing crude prices and demand-pull inflation which was due to AD development. Now for these two options of prices, the policymakers had to weigh the benefits of growth against the costs of higher prices. The change in the computer illustrates an important conflict between maintaining inflation suppression and reducing poverty through increased output, a challenging decision for policymakers in the face of these two alternatives.

These interactions show us that economic policy is complicated. Central banks must consider the long-term effects of changing interest rates, as well as the effects on funding, usage, and financial stability. An infrastructure project may grant them a temporary increase, but prudent economic policy to keep runaway inflation in check is necessary to ensure sustained growth.

A challenge in economic policy is promoting socioeconomic development alongside the suppression of inflation, which requires flexibility in the policy framework.

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