

Econ 100B: Economic Analysis – Macroeconomics
Problem Set #9
Due Date: November 14, 2020

General Instructions:

- Please upload a PDF of your problem set to Gradescope by 11:00 pm.
- **Late homework will not be accepted.**
- Please put your name and student ID at the upper right corner of the front page.

1. Some supply-side economists argue that decreasing taxes will result in higher output at current target inflation with no change in the policy rate.
 - (a) What changes in investment and potential output are supposed to follow from a decrease in taxes according to supply-side economics?
 - (b) If the assumptions of supply-side economics hold, is it possible for (i) a loss-function-optimizing central bank to not raise the policy rate and (ii) inflation to not increase or to possibly decrease? Refer to the optimal-policy rate equation and the Phillips curve in your answer.
 - (c) Significant increases in Y^P have historically happened only a couple of times in the last century. Briefly discuss the practical implications of this for the supply-side view that decreasing taxes will result in higher output at current target inflation with no change in the policy rate.
2. In *The Austerity Delusion* Prof. Blyth notes that Canada “was able to cut and grow in the 1980s,”
 - (a) Use the IS curve to briefly explain this result from the perspective of an austerity supporter.
 - (b) Use the IS curve to briefly summarize Prof. Blyth’s explanation of Canada’s experience.
 - (c) What role do unions play in the success of the mechanism you discussed in part **2b**
3. Briefly explain the difference between debt and deficit.
4. Use the IS curve to explain how Ricardian Equivalence works.