Empirical Business Cycles: Key

1. Qualitatively, the model does well. As seen in the empirical estimation, increases in aggregate demand result in more inflation and else output. The specific shape of the New Keynesian model's IRFs, however, are not too consistent with the data. Specifically, the effects of demand shocks in the theoretical model are more immediate than those from the actual data.

2. Probably. Most estimates of the fiscal multiplier ($\frac{\partial Y}{\partial G}$) are positive. There is also some evidence that fiscal policy is more effective during recessions. There are other factors, however. For example, if a country has a high debt to GDP ratio, then fiscal policy is less effective. In this case, it is possible for more spending to not increase output.

3. False. Most estimates of the tax multiplier ($\frac{\partial Y}{\partial T}$) are negative.

4. This scenario describes the right hand side of the Laffer Curve. Here, tax cuts incentive labor supply so that the increase in output (the tax base) offsets the lower rate and tax revenue increases. This may occur for sufficiently high tax rates.

5. The empirical evidence suggests that most developed economies, including the United States, are not on the right hand side of the Laffer Curve.

6. False. Theoretical models also yield IRFs. Comparing these to those from the data is an important tool for judging theoretical models.

7. There are multiple interesting answers. Here is mine:

- There would be no immediate effect because the change would not immediately affect the composition of the current student body.

- As inferior classes were admitted, the quality would decline.

- As Bates began to take a reputational hit, the quality of applications would deteriorate amplifying the decline.

- Eventually, the Trustees would fire the administration and Bates would begin to regain some of the lost quality.