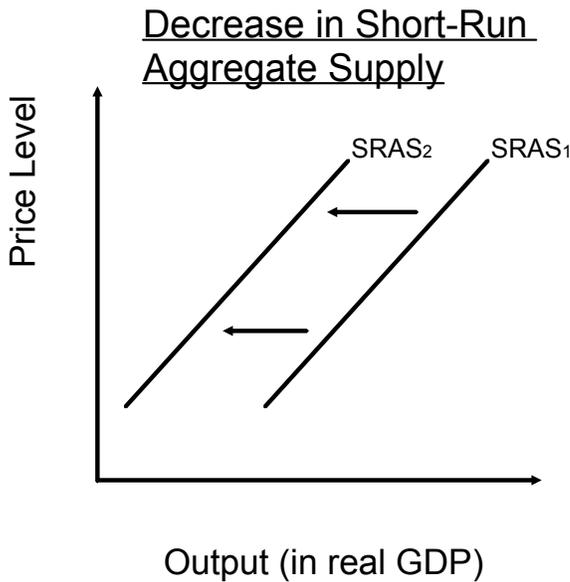


1. With the help of a diagram, explain three possible causes of a decrease in the SRAS curve.

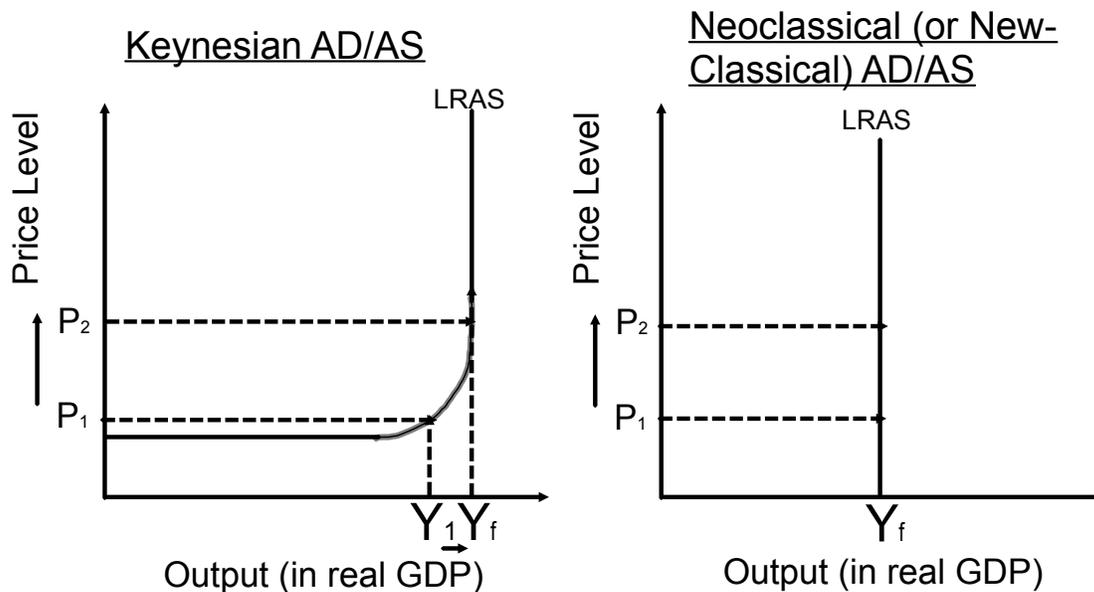


1. An increase in wages. If workers cost more, employers won't be able to afford to supply as much. (But any negative effect on output could be offset by an increase in AD or reduced profits for enterprise/management.)

2. An increase in costs of raw materials. If a vital resource such as oil costs more, it becomes harder to produce just about everything.

3. An increase in import prices. If foreign-made components go up in price, it becomes harder to make finished products.

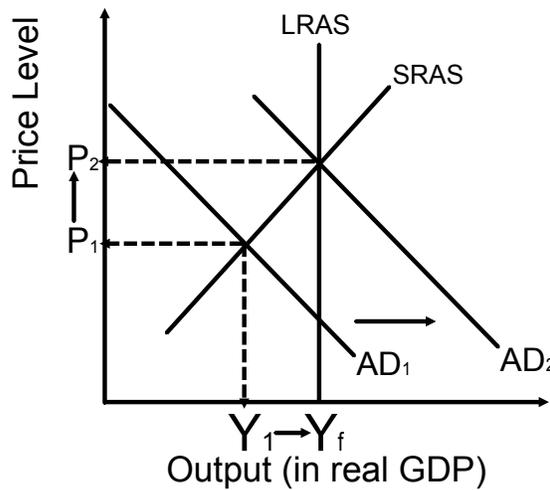
2. With the help of diagrams, explain the difference between the Keynesian LRAS and the neo-classical (or new-classical) LRAS.



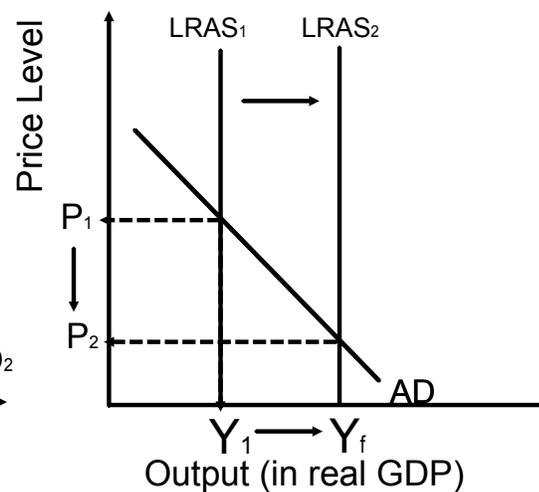
On the Keynesian LRAS, an increase in the price level can result in an increase in output. On the new-classical LRAS, an increase in the price level has no long-term effect on output.

3. How might a reduction in taxes be considered as both a demand-side policy and a supply-side policy?

Demand-side policy



Supply-side policy



Reducing income taxes puts more money into people's pockets, possibly encouraging them to spend more. This increases consumption (C), and thus AD. The opportunity to keep more money may also encourage people to work more, which increases the amount of labor available and, thus, LRAS. Reducing corporate taxes may encourage businesspeople to invest in more capital, which also increases the LRAS. (This assumes they don't just take more profits.)