Economics 104
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Problem Set #6

1. The Forbidden Kingdom is well described by the following equations:
\[
Y = C + I + G + NX
\]
\[
C = 1000 + \frac{3}{4}(Y - T)
\]
\[
T = -2667 + \frac{1}{3}Y
\]
\[
I = 2000
\]
\[
G = 2500
\]
\[
NX = -500
\]
Potential Output \(Y^* = 15,500\)

a. What is the current level of output? Are we in a recession or a boom?
b. What is the budget deficit or budget surplus?
c. Suppose there is a balanced budget amendment which requires the government to maintain a balanced budget by adjusting G. What is the required level of G, and the resulting level of output?
d. Suppose there is a balanced budget amendment which requires the government to maintain a cyclically adjusted balanced budget\(^1\) by adjusting G. What is the required level of G, and the resulting level of output?
e. What is the level of G necessary to get the economy to operate at potential output?
f. Is this level of G possible if the government is required to maintain a balanced budget?
g. Is this level of G possible if the government is required to maintain a cyclically adjusted balanced budget?

2. Ch. 16, p504, #2
3. Ch. 16, p504, #4

4. Ch. 17, p530, #4
5. Ch. 17, p530, #5

These are all “Problems and Applications.”

Due Thursday 26 April

\(^1\)The cyclically adjusted budget balance, sometimes known as the full employment budget balance, is the budget balance that we would theoretically have if GDP was operating at potential output.