1. An economy is in long-run equilibrium when output equals potential output. Why is there no long-run equilibrium rate of potential inflation? 

2. According to the economy's *self-correcting mechanism*, how does the economy return to potential output following a negative demand shock? How is the recovery process different, if the government implements a policy of economic stimulus?
3. The Volcker Disinflation (1980-1986) was costly in terms of output and unemployment. Would it not have been better to reduce inflation with a positive supply shock, rather than a negative demand shock?

4. In his first State of the Union speech in January 2010, President Obama proposed a tax credit for small businesses and tax incentives for all businesses that invest in new plant and equipment.
   a) What is the anticipated effect of these proposals on aggregate demand, if any?
   b) Show your answer graphically.
5. Evaluate the accuracy of the following statement: "The recent (from December 2008 to December 2009) depreciation of the U.S. dollar had a positive effect on the U.S. aggregate demand curve."

6. Oil prices declined in the summer of 2008, following months of increases since the winter of 2007. Considering only this fall in oil prices, explain the effect on short-run aggregate supply and long-run aggregate supply, if any.