Midterm: macroeconomics and government assignment

Compare the effectiveness of monetary and fiscal policy in terms of rising and lowering real GAP 9. (10 points) Assume that a hypothetical economy tit an MAC of . 8 is experiencing severe recession. By how much would government spending have to increase to shift the aggregate demand curve rightward by $25 billion? How large a tax cut would be needed to achieve this same increase in aggregate demand? Why the difference? Determine one possible combination of government spending increases and tax decreases that would accomplish this same goal. 10. 7 points) What are government’s fiscal policy options for ending severe demand-pull inflation? Use the aggregate demand-aggregate supply model to show the impact of these policies on the price level. Which of these fiscal policy options do you think might be favored by a person who wants to preserve the size of government? A person who thinks the public sector is too large? 1 1. (10 points) Explain why relatively flat as opposite relatively steep labor demand curves are more consistent with the empirical observation that there are relatively minor changes in the real wage rate over the course of the business cycle. 2. (7 points) Is sustainable long-run equilibrium always reached when the AD and ASS curves intersect? Why or why not? 13. (7 points) If the equilibrium real age remains constant, what happens to the nominal wage when the actual inflation rate exceeds the expected inflation rate? 14. (7 points) “ In the steady state, the government benefits from inflation. ” Explain. Answers Question 1 . Studies have proven that presidential election outcomes are definitely related to the performance of the economy.

The winning presidential party retains the office of presidency while personal income grows at a faster, higher rate than the long-term rate. The incumbent presidential party will be voted out of office when income grows at a rate lower than the long term rate. Question 2. Microeconomics meaning small, is a branch of economics that studies the behavior Of individual households and firms by making decisions On the allocation of limited resources. Normally, it applies to markets where goods or services are bought and sold.

Macroeconomics meaning large, is a branch of economics dealing with the performance, structure, behavior, and decision-making of an economy in a whole, rather than individual markets like in Microeconomics. This includes national, regional, and global economies. Question 3. Depreciation + Net Investment = Gross Investment f I rearrange it, it will say; Depreciation -?? Gross Investment Net Investment Since capital stock of an economy only rises when net investment is positive, that is when gross investment exceeds depreciation.

So naturally the capital stock falls when net investment is negative, that is when gross investment is less than depreciation. In 1933 net private domestic investment was minus $6 billion. This does NOT mean the country produced no capital goods: what it means is that the production of capital goods was less than what was lost due to wear and tear, thus the net impact was an overall loss in capital stock. Gross private investment in most cases cannot be negative, since you can decide not to invest in new factories, but how do you decide to make a negative investment on an economy wide scale.

Question 4. Household consumption has been diminishing or is flat to be honest. Income and employment rates have slowly been declining or stays in one particular place. Energy producers have increased the percentage of household budgets for fuel and electricity. According to economics, it shows minimal growth since 2001. Question 5. The IS function is the investment-saving function. A shift to the right implies hat for any given level of output the interest rate has gone up, and vice versa.

Now for the examples: (a) A change in lump-sum taxation: A lump-sum reduction in the tax rate has the same effect as increased government deficit with people and firms increasing their spending, pushing out the IS curve. (b) A change in government spending: Increased government spending will have the same impact as lower savings, and will push the IS curve to the right Question 6. The ELM function is liquidity preference minus the money supply. It tells that real money balances are a primary function of the interest rate and real income.

This is usually represented as M/P = L(r, Y), which states real money balance M/P, where M is nominal money balance and p is price level, depends on the real interest rate r and real output Y. An increase in money supply will cause the ELM curve to shift to the right, thus lowering the equilibrium interest rate and increasing the equilibrium output. An increase in the demand for money should have the same impact: shift the ELM curve to the right. If the price level falls the ELM curve will shift to the right since real money balances will increase in such a case.