

Forensic scienceexample essay



**ASSIGN
BUSTER**

Consider an economy where the current level of real GDP is at its potential level. Suppose there is an exogenous increase in savings in this economy. Using the 45-degree diagram, explain the short-run macroeconomic implications of this change in savings behavior.

INTRODUCTION: In any given economy if the current level of real GDP is also the economy's potential level of GDP, what this implies is that the economy is maximally applying all its factors of production in productive processes given the existing level of technology. At this state, the economy is said to be at the full employment level. From the diagram above, we can deduce that the initial equilibrium was at y_0 . If the economy experiences an exogenous increase in the level of savings the savings function will shift upwards from s_0 to s_1 . Regardless of whether the economy is a closed economy or open economy, we expect some short run changes but the magnitude will depend on whether the economy is open or closed.

If we apply the simplified version of Solow's growth model we realize that if we are dealing with a closed economy, then the level of savings will be equivalent to the level of investments. Since savings and economic growth are positively correlated, we expect the following short run changes. ON EXOGENOUS EXPENDITURE: An exogenous increase in savings means that this increased amount in savings is influenced by factors outside our model. This form of increase will cause the savings function to shift upwards but it will remain with the same slope gradient in the short run. The increase in exogenous savings will not have a direct impact on exogenous expenditure within the short run.

This is because the level of exogenous expenditure can only be defined outside the model. ON INDUCED EXPENDITURE: Induced expenditure is the level of expenditure increases within the economy that are influenced by the level of real GDP. In contrast, autonomous expenditures are the expenditures that are not influenced by the level of real GDP. Because the exogenous increase in savings will have an immediate effect on total savings, then we expect that the increased savings will also lead to an increase in the basket of goods and services that the economy can command. This will be reflected in the diagram above with the level of potential GDP shifting upwards to a new potential equilibrium point y_1 .

When this happens then the economy will be now producing a level of real GDP that is lower than the potential GDP. This will then lead to an increase in induced expenditures in order to bridge the gap. ON EQUILIBRIUM GDP: The equilibrium level of GDP is that level of gross domestic product that can be produced or attained when the level of national income is equal to total aggregate demand. In this case, as it can be seen from the 45-degree diagram above we can deduce that if exogenous savings affect induced expenditures vis-a-vis total expenditures then aggregate demand will be affected. Aggregate demand will increase relative to the level of increased expenditures.

This will shift the new level of equilibrium real GDP upwards. ON THE LEVEL OF UNEMPLOYMENT: Increased exogenous savings do not necessarily reduce the level of unemployment. This is because there is no direct relationship between savings and unemployment. However, incase the increased savings are used for investment in productive activities there is always the possibility

that due to increased investment activities the unemployment rate can be reduced. CONCLUSION: In addition to these direct effects, other factors can add on to this. Issues like Policy measures (tax cuts and or investment subsidies) do affect steady state level of output in the end.

Issues of capital accumulation also affect the economic growth especially in times of economic convergence. QUESTION 2 (20 Marks) “ Many observers worry that when the economy of the United States sneezes, the rest of the world catches a cold. ” Using the 45-degree diagram, explain why this might be true. What implications, if any, are there for macroeconomic policy in a country such as Australia? Explain. EXECUTIVE SUMMARY: The interrelationship between the United States economy and many other economies is very crucial. The United States boasts of the world’s largest economy, as thus the United States dollar is used as the world’s major exchange currency.

Due to this fact, it is usually of ultimate importance that the United States economy remains as a stable economy. The 45-degree diagram below will help us understand this importance in detail. From the diagram above lets make the assumption that the United States economy is at a level of full employment or close to full employment (Y_0). Now lets assume that the Federal Reserve decides to increase interest rates two fold.

In addition to this lets assume that the government also is pressured to increase taxation. If this were the case then we would expect the level of investments as well as the level of savings to decline (from I_1 and S_1 to I_2 and S_2 respectively). From the diagram above, we can deduce that if this

was to happen the equilibrium employment level will move towards Y_1 .

When this happens consumer spending within the United States for both durable and non-durable goods within the United States will come down.

When this happens given the level of correlation between the Australian and the American economy, we would expect the following macroeconomic implications.

Firstly, as an aspect of international trades the United States economy would have to reduce its imports from Australia. This would be a major blow to the Australian economy given the fact that the United States is one of its major importers. In addition to this, the United States would have to reduce its manufacturing activities and this would mean that Australia would have to lose some of the imports it derives from the United States. From a monetary policy perspective, the Australian economy would have to bear the cost of a depreciated exchange rate since the ensuing actions would affect the exchange rate.

In addition, the Australian economy would suffer together with the rest of the world since the depreciation of the dollar would mean that the entire international trade transactions would be affected since they use the United States dollar as the major exchange rate currency. To offset these effects many economies the world over would have to adjust their fiscal and monetary policies to avoid further losses. In addition, depending on whether the specific country operates a floating currency, a managed float or a pegged exchange rate each economy would have to find a way of dealing with the problem. There is also need to note that the United States economy is an open economy. On top of this, it is necessary to note that a substantial

portion of the GDP of the United States is because of foreign direct investments within the United States. What happens in this instance is that if the equilibrium GDP shifts inwards from Y_0 to Y_1 then what this means is that there will be a ripple effect in the home countries of some of the major investors within the United States economy and this includes Australia.

CONCLUSION: Globalization has its merits and demerits. Issues of open economies free trade and liberalization of the economy are all because of globalization. Issues of the united states sneezing and the rest of the world coughing are all because of globalization. What all other economies need to do is literally find a way of getting themselves allergic to economic coughs. Once this happens, it will no longer be possible for the United States to sneeze and the rest of the world economies getting the cough.

This process will not happen overnight, or within a fortnight, but am sure it can happen. Therefore, what all other economies need to do is adopt informed fiscal and monetary policies. If these policies are implemented in a sound manner there is a great deal that, these economies can do especially in Asia, Latin America and sub-Saharan Africa. REFERENCES: Eugene F.

Brigham and Michael C. Ehrhardt (2005) Financial Management: Theory and Practice, Thomson Southwestern.