Economics test questions

Economics

Assignment #1 - Model Answers Aim for around 1000 words and certainly no more than 1250 words Last week, Japan's government downgraded its views on consumer sentiment and machinery orders, while the Bank of Japan effectively cut its assessments on exports. The Wall Street Journal, August 13th, 2012. A) Using the basic Keynesian model, provide a detailed analysis of the likely impact of the changes described above for Japan's real GAP and rate of unemployment. (20 marks) b) Suppose the government responds to what you have outlined in part (a) with a change in fiscal policy. What would the government be trying to achieve?

Explain how this might impact on the stock of public debt. (10 marks) Note: You need to demonstrate a detailed knowledge of the construction and use of the degree diagram and any other economic analysis you use. You must make it clear that you have a complete understanding of the macroeconomic principles that underlie the model and concepts. Explain what assumptions you are making. Above all, explain the economics of what you are describing. It will be very difficult to obtain a passing mark for this assignment if you do not provide a complete explanation of exactly how and why the economy responds in the way that you are describing.

Part (a) Assume prior to the exogenous changes identified in the quote, I. E. , these changes are determined outside of the basic Keynesian model, the economy is at the initial equilibrium level of GAP denoted by Y* (full employment), illustrated in Figure 1 . The initial equilibrium is characterized by an equivalency between planned aggregate expenditure, PAP, and output, Y; and between planned injections, J P , and withdrawals, W. The initial equilibrium is consistent with points A and A' on, especially, the initial planned aggregate expenditure schedule, PAVE, and the withdrawals schedule, WOO (Brenan et. L. 2008, 209). At this level of income, there will be no unplanned change to inventories. Note also that unless there is an exogenous change, we would expect the economy to remain at this equilibrium. Also shown on the Figure is the economy's consumption function, C d - CT + c(l - For future reference, also note that the vertical intercept of the PAP schedule includes both planned injections, J P , and exogenous consumption, C - CT and that the intercept of the W schedule is - C + CT 1. (Y + [1 -c(l FIGURE 1 450 PAP PAVE Economics Test Questions By thighbone AWAY* The exogenous changes in the quote will have the following immediate effects: (1) An exogenous fall in consumer sentiment is most likely to affect the level of exogenous consumption, C , pushing it downwards, reflecting a desire by households to boost saving given their growing pessimism about the state of the economy.

This lowers the intercepts of the consumption and PAP schedules and raises the intercept of W. (2) As planned investment is a component of planned injections (together with exports ND government expenditure), a fall in machinery orders implies the planned injections line, COP, will shift downward by the amount of the exogenous fall in planned investment. (3) Likewise, a fall in exports orders will also imply the planned injections line, COP, will shift downward.

Figure 2 shows the downward shifts in; the economy's planned injections schedule to Jell ; the consumption function to Cold ; and the corresponding downward move of the economy's planned aggregate expenditure schedule, from PAVE to PIE (note that the PAP schedule is derived by adding leaned injections to domestic consumption - the fall in planned injections and exogenous consumption results in a lower vertical intercept for PAP). P FIGURE 2 450 PAP PAVE PIE A B Immediately after the fall in planned injections, the economy's level of GAP is still the full employment level Y*.

However, this now represents a situation of disequilibrium. From Figure 2, it is apparent that point B, the point on the new PAP schedule that corresponds to Y*, represents a level of planned expenditure that is below Y*, hence the requirement for equilibrium, that PAP = Y, is not met. Similarly, the corresponding points on the new withdrawals and planned injections lines, B' and B", show a level of planned injections below withdrawals - the requirement for equilibrium that planned injections equal withdrawals, is not met.

Whilst planned injections no longer match withdrawals, actual injections are still equal to withdrawals. This is because the fall in planned aggregate expenditure results in an unplanned accumulation of inventories as firms find they are unable to sell all that is produced (changes in inventories are a component of investment expenditure and are therefore part of actual injections - hence, whilst planned injections have fallen, actual injections have not fallen).

Note that this unplanned increase in inventories is represented by the distance B'- B". The unplanned accumulation of inventories provides a signal to firms that production needs to be cut, thus lowering GAP and hence, from the circular flow, income. The resulting decrease in income induces a decrease in withdrawals and consumption and PAP schedules, as shown in Figure 3. This continues until PAP and production