Economics 102 Name ______________________________

Summer 2017

Quiz #4

June, 21, 2017

Write all answers neatly and legibly.

1. Use the short-run Keynesian Model to answer this set of questions. You are given the following information:

$C = 10 + .8(Y – T)$ where C is consumption spending, Y is real GDP, and T is taxes

$T = 20$

$TR = 0$ where TR is transfers

$G = 10$ where G is government spending

$I = 10$ where I is planned private investment spending

$X – IM = 5$ where X is exports and IM is imports

a. (2 points) Examine the above information and then answer the following questions:

i. This economy is operating with a government budget ________________.

ii. This economy is operating with a trade _______________.

iii. This country is (lending to, borrowing from) foreign countries.

iv. This country's private saving function, Sp, with respect to real GDP can be written as the equation: _________________________.

b. (1 point) Given the above information calculate the equilibrium values of Y and C for this economy. Show your work to get full credit. Put your final answer in the provided blanks.

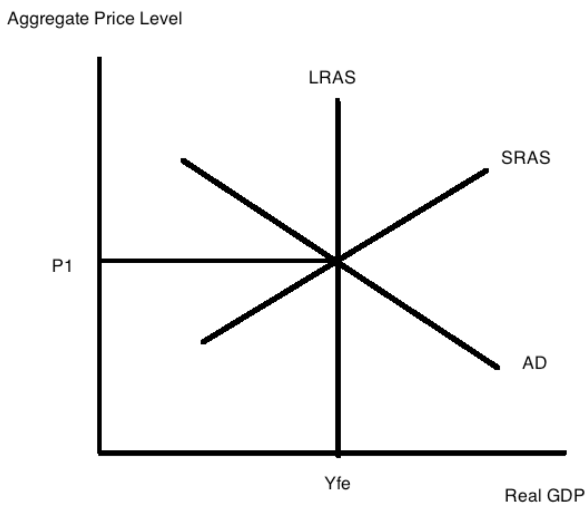
Equilibrium level of Y = _________________

Equilibrium level of C = _________________

c. (1 point) Suppose the government increases its level of government spending to 30 (G' = 30). Holding everything else constant, what will be the **<u>direction and change</u>** in real GDP due to this spending change? Show your work to get full credit.
The direction and change in real GDP will be ____________________________.

d. (2 points) Go back to the initial information. Suppose that this government decides to increase government spending by 20 and taxes by 10 in order that they have a balanced budget. Write a verbal statement of what you think the impact of these spending changes will be on real GDP in this economy given this model and the initial information. No numbers necessary here: for full credit give a well-reasoned, logical answer.

2. Consider an economy that is initially in long run equilibrium where Y, real GDP, is at its full employment level (Yfe) and the aggregate price level is P1. **For this economy assume that its aggregate production function exhibits diminishing returns.** The following graph represents this economy where LRAS is the long run aggregate supply curve, SRAS is the short run aggregate supply curve, and AD is the aggregate demand curve:



a. (1 point) Given the initial situation, if the government increases its level of spending and everything else is held constant, what does this model predict will happen to the equilibrium level of output and the equilibrium aggregate price level in the short run? Explain your answer for full credit.

b. (1 point) Given the initial situation, if the government increases the level of net taxation in the economy and everything else is held constant, what does this model predict will happen to the unemployment rate in this economy in the short run? What do you predict will happen to labor productivity in the short run for this economy? Explain your answer for full credit.

c. (1 point) Given the initial situation, if the government decreases its level of spending and everything else is held constant, what does this model predict will happen to the equilibrium level of output and the equilibrium aggregate price level in the long run? Explain your answer for full credit.

d. (1 point) Given the initial situation, if the government passes legislation that provides businesses with an incentive to invest then what do you predict will happen in the short run to real GDP in this economy? What do you predict will happen in the long run in this economy? Hold everything else constant when you do your analysis. Explain your answer for full credit.