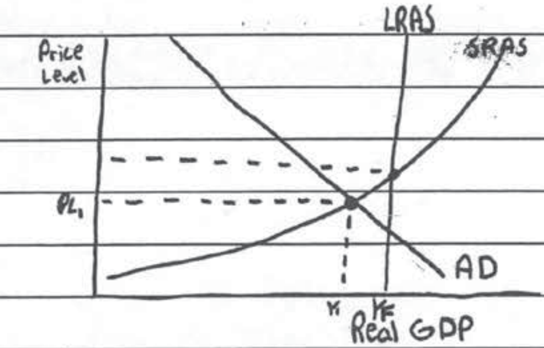
q1 macro 2014

1) a.



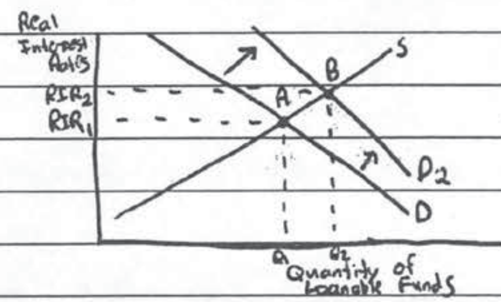
Ignore top dotted line going towards the Price Level Axis. I cannot erase or cross it out

b). The increase in government spending will decrease cyclical unemployment. The increase in government spending will have no effect on the natural rate of unemployment.

c). $\frac{1}{.25} = 4$ $100 \times 4 = 400$

The maximum possible change in real GDP that could result from a 100 Billion dollar increase in government spending and a MPC of 0.75 is 400 Billion Dollars.

d).



The 100 Billion dollar increase in government spending will shift demand to the right, resulting in increased Real Interest Rates.

e) Based on the increased Real Interest Rates, the long run economic growth rate will decrease because Businesses are discouraged to invest with higher interest rates, and business investment is a component of the expenditures method of AD [CIGX]. Therefore, Aggregate demand will slow down with less business investment, and Aggregate Demand influences long run economic growth. Essentially, the crowding out effect will take place.

GO ON TO THE NEXT PAGE.

q1 macro 2014 continued

f) ~~The 100 Billion Dollar Tax cut will also~~

The real Gross Domestic product will still increase because the spending multiplier is 1 more than the taxing multiplier, therefore the 100 Billion dollar spending will have more of an effect than the 100 Billion dollar tax increase, so real GDP increases.