Write in the box the number of the question you are answering on this page as it is designated in the examination.

1 MACP1

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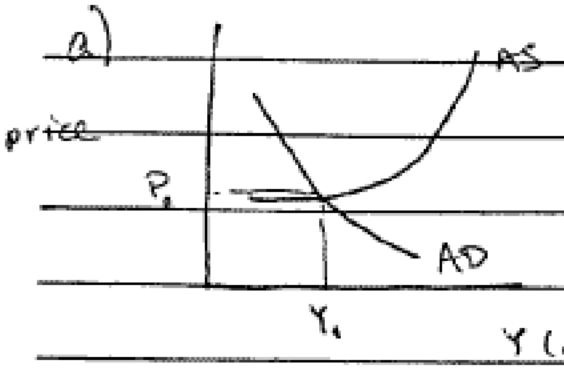
a)



flat part of AS curve is where economy is running on low capacity - recession

b) Decreasing taxes or increasing gov't expenditures is part of expansionary fiscal policy; both policies result in increase of Y or GDP. However, increasing G will have a greater impact on GDP b/c in general, the gov't spending multiplier is greater than the tax multiplier. So the ΔY as a result of ΔG is greater than the ΔY resulting from ΔT if $\Delta G = \Delta T$.

Ex) $MPS = .2$ $MPC = .8$ $\Delta G = \Delta T = 100$

gov't spending mult. $= \frac{1}{MPS} = \frac{1}{.2} = 5$

$\Delta Y =$ mult. $\cdot \Delta G = 5 \cdot \$100 = \$500$

tax multiplier $= -\frac{MPC}{MPS} = -\frac{.8}{.2} = -4$

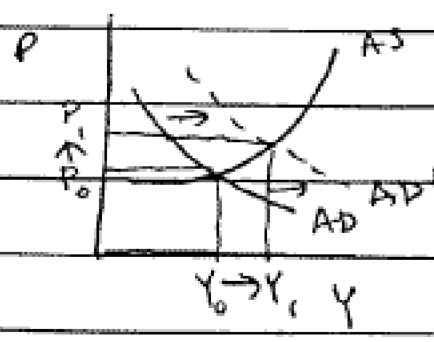
$\Delta Y =$ mult. $\cdot \Delta T = -4 \cdot -\$100 = \$400$

$\$400 < \$500$

cont. on p. 5

So $\uparrow G$ causes a greater increase in GDP than (tax cut) a tax cut does.

c) i) Tax cut → increase in disposable income → increase in consumption & saving → AE↑ → unplanned fall in inventory → production ↑ → aggregate output ↑



ii Tax cut causes AD curve to shift (R) so GDP and price level increase.

(iii) Because consumers have more income and will consume more, they will buy more imports.

1

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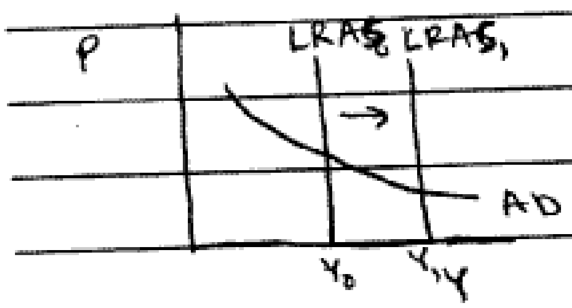
c) (iv) Because of the tax cut, the price level increased (see part ii). So US goods are more expensive abroad so foreigners will demand less US goods. Thus, US exports fall.

d) (ii) An increase in net investment means there is more capital in factories and firms which leads to greater productivity. Firms can produce more so the aggregate supply increases (shifts R)



(i) Each point on the aggregate demand curve is a point of equilibrium where aggregate expenditure equals aggregate output or income) so

$$Y = \underbrace{C + I + G}_{AE}$$

An increase in investment causes AE↑ and in order to keep equilibrium, Y will increase as well. So the AD curve shifts R (increases)