ECO 120: Global Macroeconomics **Name:** ____________________

Prof. James Murray - Fall 2014

Practice Exam 2 **Section (Circle): 2:15pm-3:40pm 3:55pm-5:20pm**

1. Consider the following government policies. Describe and illustrate how each influences the *long-run* level of output per worker, if at all.

   (a) (7 points) Suppose a country reduces its legal barriers to foreign direct investment, which makes it more profitable for foreign companies to develop manufacturing and service facilities in a country.

   (b) (7 points) Suppose there is a fear among business owners in Ukraine that political turmoil will continue and possibly turn to violence.

   (c) (7 points) Suppose a developing country has an adult population where very few people pursue education beyond high school. It is believed that the lack of a sufficiently skilled workforce is partly to blame for the lack of growth of the manufacturing sector. Suppose the national government implements a new policy that gives people money to pursue college education in one and two year degree programs in technology fields related to manufacturing.

   (d) (7 points) The government increases its spending on wasteful crap, causing larger government budget deficits.

2. Suppose that on average when people see an increase in income of \$150, their spending on final goods and services increases by \$120, and of this, \$20 goes toward goods that are produced abroad.

   (a) (8 points) Suppose a boost in consumer confidence leads to an increase in consumption spending by \$50 billion. What is the immediate effect on real GDP?

   (b) (8 points) Suppose the economy is in a recession, real GDP is currently \$13 trillion and potential GDP is \$15 trillion. The president decides to increase government spending to solve the problem. How much should government increase its spending by?

3. With continued innovations in internet and communication technology, more and more financial and information technology services consumed in the United States are easily imported from abroad. Suppose as a result there is an increase in the fraction of an increase in income that is spent on imports.

   (a) (8 points) What is the effect on the expenditure multiplier?

   (b) (8 points) What is the implication for the stability of real GDP in the face of domestic speculative shocks to consumer and investment confidence.

4. (8 points) Suppose financial and credit markets grow in such a way that makes credit more easily available to consumers. Suppose that in the years following this development, many consumers decide to save less and borrow more, to finance purchase of goods and services that improve their lifestyle. Describe and illustrate the impact on the equilibrium level of investment and equilibrium interest rate.

5. (8 points) Suppose a poor, under-developed country develops a new network of roads and highways that makes development of new manufacturing facilities, warehouses, and distribution centers more productive / more profitable. Describe and illustrate the impact on the equilibrium level of investment and equilibrium interest rate.

6. (8 points) Suppose the most recent recession and financial crisis causes consumers to be more cautious, permanently increasing the fraction of income that they save. Describe and illustrate the impact on the equilibrium level of investment and equilibrium interest rate.

7. Suppose the labor market is in equilibrium, when there is a drop in demand for final goods and services.

   (a) (8 points) Describe and illustrate the effect on the equilibrium level of employment and the equilibrium wage rate.

   (b) (8 points) Suppose the curve(s) shift as you describe them in part (a), but short-run sticky wages prevent the wage from changing from its initial equilibrium level. Given the shift(s) and no change in wages, describe the effect on the labor market.