ECO 120: Global Macroeconomics **Name (10 points):** ____________________

Prof. James Murray - Fall 2015

Practice Exam

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

   (a) (5 points) Global nonprofit organizations work in a small developing country to improve its health and sanitation conditions.

   (b) (5 points) Suppose past financial and economic turmoil cause businesses operate with a greater degree of risk aversion.

   (c) (5 points) While balancing the government budget, the government increases its funding for research and development into new technologies.

   (d) (5 points) Suppose in an effort to reduce the government budget deficit, the government cuts a number of spending programs but leads taxes unchanged.

2. Suppose that a past tax rebate of $450 for full-time workers resulted in an increase in total consumption spending of $400 and an increase in imports equal to $25.

   (a) (5 points) Suppose an drop in consumer confidence leads to a decrease in consumption spending by $175 billion. Calculate the immediate effect on real GDP.

   (b) (5 points) Suppose the economy is in a recession, real GDP is currently $10 trillion and potential GDP is $12 trillion. The president and congress decide to increase government spending to solve the problem. Compute the size of the increase in government spending needed to bring real GDP back to potential GDP.

3. Suppose there is a permanent change in consumer behavior such that consumers decrease the fraction of any additional income that they save.

   (a) (5 points) What is the effect on the expenditure multiplier?

   (b) (5 points) What is the implication for the stability of real GDP?

4. (5 points) Suppose businesses' expect higher future demand for their products and services. Describe and illustrate the impact on the equilibrium level of investment and equilibrium interest rate.

5. (5 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 interest rate.

6. (5 points) Suppose in a small developing country that immigration restrictions are relaxed, which results in an increase in the number of skilled workers. Describe and illustrate the impact on the equilibrium level of investment and interest rate.

7. Suppose the labor market is in equilibrium and the market for final goods and services is at the long-run equilibrium. Suppose then that there is a decrease in average income in European countries which are major trading partners with the United States. Answer the following questions from the perspective of the United States?

    (a) (5 points) Describe and illustrate the *short-run* impact on the market for final goods and services. What is the impact on price level and real GDP?

    (b) (5 points) Describe and illustrate the *short-run* impact on the labor market. What is the impact on wages, employment, and unemployment?

    (c) (5 points) Describe and illustrate the *long-run* impact on the labor market. What is the impact on wages and employment?

    (d) (5 points) Describe and illustrate the *long-run* impact on the market for final goods and services. What is the impact on price level and real GDP?

8. Suppose the economy is experiencing stagflation. The unemployment rate is high, production level is below its potential, and price level is high.

   (a) (5 points) Illustrate this condition in the markets for labor and final goods and services.

   (b) (5 points) Describe and illustrate a change in *tax policy* to improve the unemployment and production situation without waiting for natural convergence to the long-run equilibrium. Redraw your answer to (a) below, and add to the illustration the impact of your policy prescription.

   (c) (5 points) Begin again with the situation you illustrate in (a) and describe a change in *tax policy* to reduce inflation. Redraw your answer to (a) below, and add to the illustration the impact of your policy prescription.