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ECO 120: Macroeconomics

 ${\bf In\text{-}class} \ {\bf Exercise:} \ {\bf Keynesian} \ {\bf Model}$ 

1.	Suppose the marginal propensity to save is 0.10 and the marginal propensity to import
	is 0.15. Suppose an increase in consumer confidence leads to a \$250 billion increase in
	consumer spending. What is the change in real GDP?

2. Suppose in a country the marginal propensity to consume 90% and imports are unaffected by disposable income or real GDP. Suppose firms expect the price of oil to drastically increase next summer, which would increase the cost of transporting goods between factories and retailers, and ultimately hurt profits. Expecting this to happen, investment in the economy decreases by \$100 bn. What is the immediate change in real GDP?

3. Suppose there is a Federal tax rebate equal that totals \$100bn for U.S. consumers, in which each full-time working American receives a check for \$500. Suppose the typical person puts \$100 of this money towards their savings accounts or paying towards existing debts. They spend the rest of this, including approximately \$50 on imported goods. What is the immediate change in real GDP?

4.	Suppose the Ch	inese Yuan	$_{ m depreciates}$	against tl	he U.S. dolla	ar. Suppose if	income	were
	to increase by \$	31, savings	would rise b	y \$0.05 ar	nd imports	would rise by	\$0.20.	

(a) All other things remaining the same, will U.S. exports to China increase, decrease, or stay the same? Will U.S. imports from China increase, decrease or stay the same. Explain.

(b) Suppose in response to the appreciation of the Yuan, the initial change in U.S. exports is \$10 billion and the initial change in U.S. imports is \$15 billion (you should know whether each of these is an increase or decrease). What will be the impact on real GDP?

5. Suppose the marginal propensity to consume is 95% and the marginal propensity to import is 10%. The economy is in a recession. Real GDP is \$5.5 trillion, and at full employment real GDP would be \$6 trillion. The president decides to increase government spending to solve the problem. How much should government spending be increased by?

6.	What happens to the multiplier if MPS increases from $5\%$ to $10\%$ (assume MPM=0). Which MPS gives the government greater power to influence GDP? Does this imply that the government should persuade people not to save?
7.	Suppose in a closed economy, the marginal propensity to save is 5%. Suppose the economy decides to remove its trade barriers and freely allow imports and exports. As a consequence the marginal propensity to import becomes 20%.
	(a) How does this effect the expenditure multiplier?
	(b) How does this change affect the ability of the government to fix recessions?
	(c) How does this affect the stability of GDP in the face of volatile decreases in investment caused by changes in expectations?
	(d) Is opening up the economy a good thing or a bad thing? Explain.