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

Prof. James Murray - Spring 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) While balancing the government budget, the government of a small developing country decreases its funding for health and sanitation initiatives.

   (b) (5 points) Suppose there a new trade agreement leads to a decrease in the cost of importing goods into the United States and thereby leads to an increase in the U.S. trade deficit.

   (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 on average when people get an increase in income of \$100, their savings increases by \$10, and their purchases of imported goods increases by \$15.

   (a) (5 points) Suppose an drop in businesses' economic outlook leads to a decrease in investment spending by \$150 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 decides to increase government spending to solve the problem. How much should government increase its spending in order by?

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 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.

5. (5 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. (5 points) Suppose there is an improvement in communications technology that makes workers more productive. Describe and illustrate the impact on the equilibrium level of investment and equilibrium 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 an increase in consumer confidence leads to an increase in demand for final goods and services.

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

   (b) (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?

   (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 in recession. The unemployment rate is high, production level is below its potential, and price level is low.

   (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 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 *monetary policy* to improve the 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.