

ECON2113 Macroeconomics

Chapter 12 Exercises

1. The economy is at full employment. Now the government wants to change the composition of demand toward investment and away from consumption without, however, allowing aggregate demand to go beyond full employment. What is the required policy mix? Use an *IS-LM* diagram to show your policy proposal.
2. Suppose the government cuts income taxes. Show in the *IS-LM* model the impact of the tax cut under two assumptions: (1) The government keeps interest rates constant through an accommodating monetary policy. (2) The money stock remains unchanged. Explain the difference in results.
3. Consider two alternative programs for contraction. One is the removal of an investment subsidy; the other is a rise in income tax rates. Use the *IS-LM* model and the investment schedule to discuss the impact of these alternative policies on income, interest rates, and investment.