ECON2113 Macroeconomics

Chapter 11 Exercises

1. The following equations describe an economy. (Think of C, I, G, etc., as being measured in billions and i as a percentage; a 5% interest rate implies $i = 5$.)

C	=	$.8(1 - t)Y$
t	=	0.25
I	=	$900 - 50i$
$\bar{G}$	=	800
L	=	$0.25Y - 62.5i$
$\bar{M}/\bar{P}$	=	500

   a. What is the equation that describes the *IS* curve?
   b. What is the general definition of the *IS* curve?
   c. What is the equation that describes the *LM* curve?
   d. What is the general definition of the *LM* curve?
   e. What are the equilibrium levels of income and the interest rate

2. Continue with the same equations.
   a. What is the value of α_G which corresponds to the simple multiplier (with taxes) of Chapter 10?
   b. By how much does an increase in government spending of $\Delta\bar{G}$ increase the level of income in this model, which includes the money market?
   c. By how much does a change in government spending of $\Delta\bar{G}$ affect the equilibrium interest rate?
   d. Explain the difference between your answers to parts a and b.

3. Suppose there is a decline in the demand for money. At each output level and interest rate the public now wants to hold lower real balances.
   a. In the Keynesian case, what happens to equilibrium output and to prices?
   b. In the classical case, what is the effect on output and on prices?