

Tutorial Note 2: Consumption and Goods Market

Solution to Exercises

Teaching Assistant: Harly Zhou

Exercise 1 (1) D. It is investment. (2) C. Government transfer is not counted into G .

Exercise 2

a. $Y = 480 + (0.5)(Y - 70) + 110 + 250 = 1610$ billion.

b. $Y_D = 1610 - 70 = 1540$ billion.

c. $C = 480 + 0.5(1540) = 1250$ billion.

Exercise 3

- Q5(c): Because of the automatic effect of taxes on the economy, the economy responds less to changes in autonomous spending than in the case where taxes are independent of income. Since output tends to vary less (to be more stable), fiscal policy is called an automatic stabilizer.
- Q6(c): Both Y and T decrease.
- Q6(d): If G is cut, Y decreases even more. A balanced budget requirement amplifies the effect of the decline in c_0 . Therefore, such a requirement is destabilizing.

Exercise 4 A. Simple by definition.

Exercise 5 (1) Transfers will increase during recessions when output Y decreases. For example, in recessions, the unemployment rate will increase. The government pays parts of workers' original earnings for a specified amount of time. This would help the unemployed workers and reduce the negative effects of recession on consumption.

(2) Do the iteration as we did. $\frac{1-c_1}{1-c_1(1-r_2)}$.

(3) Yes. t_0 is the combination of r_1 and the fixed tax. $t_1 = -r_2 < 0$.