

Economics 101: Basic Economic Principles

Professor Clark

Problem Set #6 (due by **the beginning of class on Wednesday, the 9th of April**)

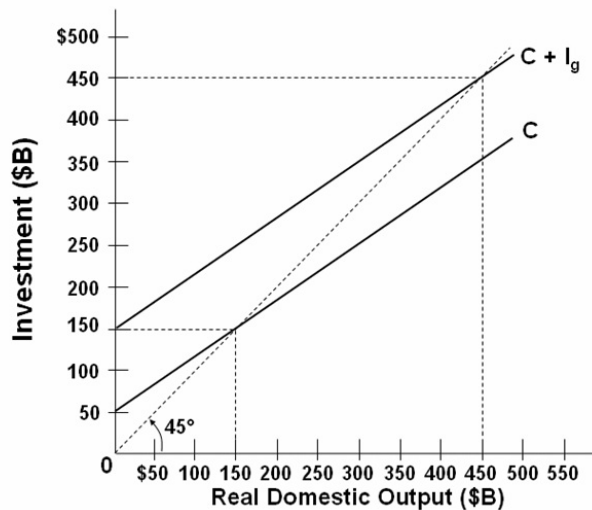
This problem set covers chapters 30. **Your explanations must be type-written, including your equations. Your diagrams can be hand-drawn.** You are welcome to work with a partner and turn in one problem set.

Multiple Choice Questions. For each of the multiple choice questions, please include a short, type-written explanation with your answer.

1. In a private closed economy, there will be an unplanned increase in inventories when:

- A. Aggregate expenditures exceed GDP.
- B. Aggregate expenditures exceed $(C + I_g)$
- C. $(C + I_g)$ exceeds aggregate expenditures
- D. GDP exceeds aggregate expenditures

2.



Refer to the above graph for a private closed economy. In this economy, planned investment is:

- A. \$50 billion
- B. \$100 billion
- C. \$150 billion
- D. \$200 billion

3. Refer again to the above graph for a private closed economy. The equilibrium level of GDP in this economy is:

- A. \$150 billion
- B. \$250 billion
- C. \$350 billion
- D. \$450 billion

4. Which of the following scenarios will shift the investment demand curve to the right?
- A. Business taxes increase.
 - B. The expected rate of return on capital increases with new technology becoming widely available.
 - C. Firms have a lot of unused production capacity.
 - D. Firms are planning to increase their inventories given their increased optimism for stronger economic growth.

Short Essay Question.

Consider the following estimates for a closed private economy:

a (autonomous consumption expenditures) = \$500 billion

b (marginal propensity to consume out of disposable income) = 0.9

I_g = \$400 billion

A. Calculate current equilibrium income (real GDP) for the economy. Illustrate this equilibrium on an AE-Y diagram. Be sure to fully label your diagram, including the level of autonomous expenditures in the economy and the slope of the AE function.