

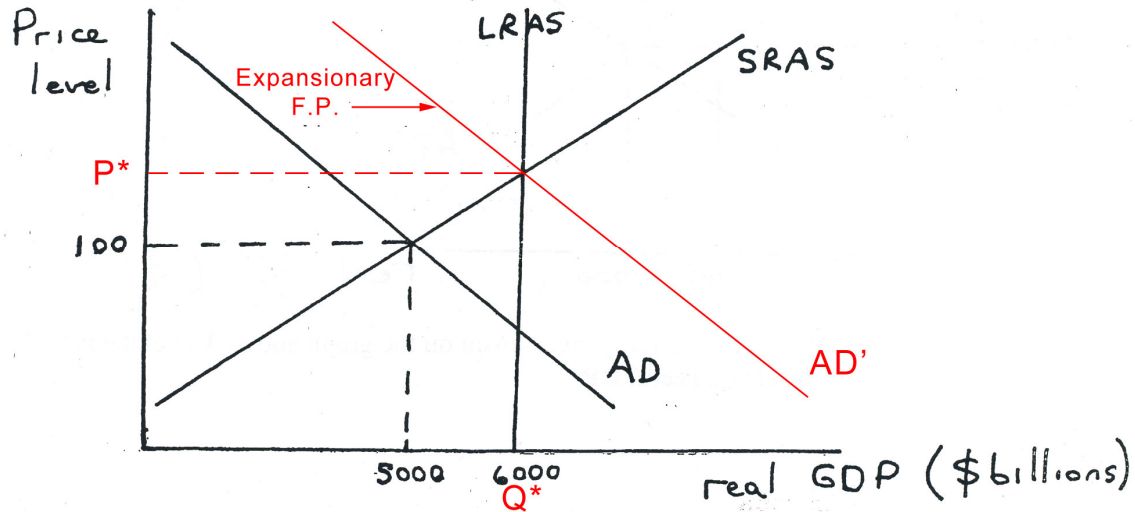
Macroeconomic Principles
Third Exam – Fall 2005
Schellberg
Answer Section

Multiple Choice

- 1: E
- 2: B
- 3: C
- 4: A
- 5: B
- 6: C
- 7: C
- 8: B
- 9: D
- 10: D
- 11: A
- 12: C
- 13: B
- 14: B
- 15: D
- 16: B
- 17: C
- 18: B
- 19: A
- 20: A
- 21: B
- 22: A
- 23: A
- 24: D
- 25: A
- 26: D
- 27: B
- 28: D
- 29: E
- 30: A

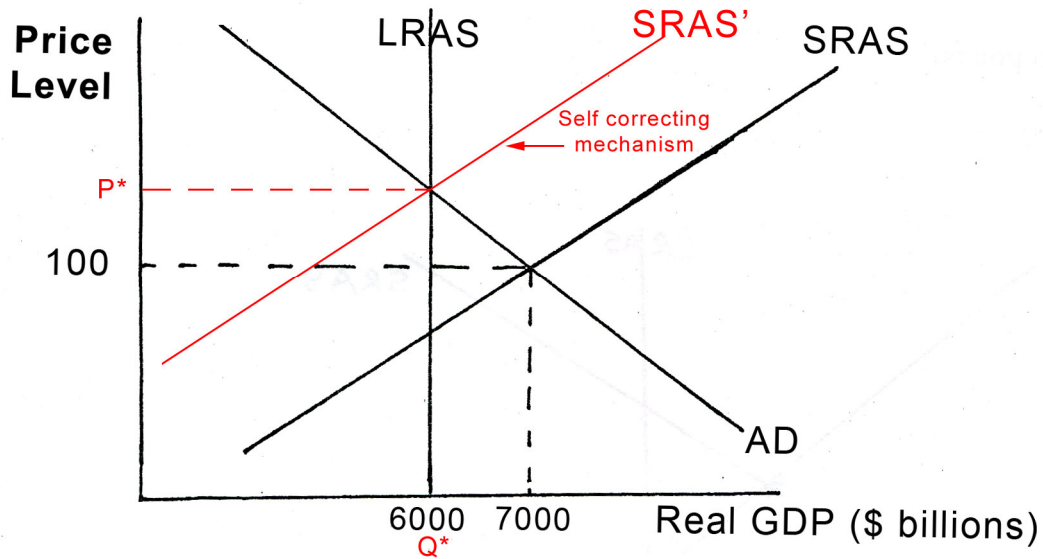
PART II (25 points)

1. (12 points)



- a. Suppose the marginal propensity to consume is .75. The government expenditures multiplier is 4 (fill in the value of the multiplier). If the government wishes to use expansionary fiscal policy to return the economy to full employment, it should (pick one: *increase*, *decrease*) government purchases by (fill in an amount) 250 billion.
- b. Show this expansionary fiscal policy on the graph above. **Label** the new equilibrium **price level** and **real GDP**.

2. (13 points) Suppose the economy is experiencing an inflationary gap.



a. Show the economy's self correcting mechanism on the graph above. **Label** the new equilibrium **price level** and **real GDP**.

b. Complete the following;

With an inflationary gap, there is a (pick one: surplus, *shortage*) of labor and other inputs. As the economy self-corrects from the inflationary gap, wages and prices (pick one: *rise*, fall), and spending on goods and services (pick one: increases, *decreases*). As a result of these changes, the unemployment rate (pick one: *increases*, decreases), so as to return to its long-run natural rate.