

Chapter 9:

1. Questions For Review numbers 4,5 (p. 285).

For #3 add: What if government spending increased rather than the money supply?

2. Problems and Applications number 3 (p. 285-86).

Note: with a fixed money supply, a decline in velocity is a decline in spending.

Chapter 10:

3. Questions For Review numbers 1,3,4 (p. 309).

4. Problems and Applications 1,2,4 (p. 309) with the following modifications.

2. For consistency with the next chapter, please interpret the assumption that  $I = 100$  as follows:  $I = 200 - 25r$ , and  $r = 4$ . I.e., investment depends on the real interest rate  $r$  (which is expressed here as a percentage rate), but for now we are assuming that this rate is fixed at 4 percent per year and consequently that investment is fixed at 100 per year.

Please add the following parts.

- 2e. Consider the dynamics of the multiplier process in part **c**. If each round of spending in the multiplier took one month, how close to the new equilibrium would the economy be four months after the increase in government purchases?
- 2f. Reconsider part **d**. Suppose that the government wishes to achieve GDP of 1,600 but wishes to do so without increasing the budget deficit? It can do this by raising both government purchases  $G$  and taxes  $T$  by an equal amount. What is that amount?
- 2g. Suppose that, instead of net taxes  $T$  being a fixed amount, net taxes are proportional to income:  $T = .2Y$ . How would this affect the magnitude of the multiplier in the Keynesian cross model? Hint: recall that the multiplier is  $1/(1-\text{slope E})$ .
4. Please add the following part.
- 4e. Many economists believe that an autonomous fall in consumption was a primary cause of the recession of 1990–91 in the U.S. Suppose that there had been a balanced budget law in place at the time. Is it likely that this law would have had a stabilizing or destabilizing effect on the economy during the recession?

Chapter 11:

5. Problems and Applications number 1 (p. 336).