Macroeconomics 1
Problem set 2

Tick the correct alternatives (more than one may be correct) or write your answer in the space provided. Unless otherwise stated, the notation and behavioural assumptions are the same as in the lectures and textbook.

1. C will increase if individuals

   a) save a smaller proportion of their income
   b) purchase more shares
   c) interest payments on government bonds increase

2. I will fall if

   a) companies purchase more government bonds
   b) there is an increase in mergers and acquisitions
   c) individuals purchase more shares
   d) companies purchase more machines

3. An economy is described by the following set of equations

$$C_t = 100 + 0.75(Y_t - \bar{T}) \tag{1}$$
$$\bar{I} = 25 \tag{2}$$
$$\bar{G} = 150 \tag{3}$$
$$\bar{T} = 100. \tag{4}$$

   a) Write down the goods market equilibrium condition? __________ What is the value of equilibrium output? __________

   b) Suppose the government increases spending by 100. In the new equilibrium, what are the values of:

      i) income? __________
      ii) demand? __________
      iii) consumption? __________

4. In our simple model of income determination assume that taxes are increasing in income, i.e. $T = \bar{T} + tY$ with $t > 0$. Investment and government expenditure are exogenous. Consumption is given by $C = \bar{C} + c(Y - T)$.

   a) Write down the expression for equilibrium output. __________

   b) What is the Keynesian multiplier? __________With respect to the case discussed in the lecture (constant taxes), does the economy respond more or less to a change in autonomous spending? __________

   c) Why do you think taxes are called an "automatic stabilizer" in this case?