Macroeconomics 1
Problem set 5

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.

All the following questions refer to a situation of long run equilibrium..

1. If firms' mark up over costs increases:

   a) the equilibrium level of consumption increases
   b) the equilibrium level of investment falls
   c) the equilibrium interest rate falls
   d) the equilibrium price level increases.

2. The investment function is given by

$$I = 150 - 1000i. \tag{7}$$

   If the government reduces government expenditure by 100:

   a) the equilibrium level of output increases by $\frac{1}{1-c_1}100$
   b) the equilibrium level of investment falls by 100
   c) the equilibrium interest rate falls by 0.1
   d) the equilibrium price level falls.

3. If due to a change in tastes people want to save less:

   a) the equilibrium level of output falls
   b) the equilibrium level of investment increases
   c) the equilibrium interest rate increases
   d) the equilibrium price level falls.

4. The government increases government expenditure G by 200. If the consumption function is given by

$$C = 100 + 0.7(Y - \bar{T}) \tag{8}$$

   and the investment function is the same as in equation (7).

   a) The government finances the increase in expenditure through debt. Write down the value of

      i) the change in the long run equilibrium interest rate __________
      ii) the change in the long run equilibrium level of consumption __________
      iii) the change in the long run equilibrium level of aggregate saving __________

b) The government finances the increase in expenditure through taxes. Write down the value of

i) the change in the long run equilibrium interest rate __________
ii) the change in the long run equilibrium level of consumption __________
iii) the change in the long run equilibrium level of aggregate saving __________