

**Cooleconomics.com**  
**Macroeconomics**

**Exam 2**

1. A small open economy is characterized as follows:

Full employment  $Y = 1000$

$$C^d = 100 + .8(Y - T)$$

$$I^d = 300 - 2000r^w$$

$$G = 200$$

$$r^w = .03$$

$$T = 300$$

- a) Calculate equilibrium values of desired consumption, government savings, national savings, current account balance, capital account balance.
- b) The government in this country wishes to reduce its capital account balance.
- i) Name an appropriate policy that will achieve this goal, and perform calculations that demonstrate the change in the capital account balance that results from the policy.
  - ii) Use a graph to illustrate how the policy changes the capital account balance. (Precise numbers aren't required on the graph.)

2. Government in a large open economy reduces government purchases.

a) Use two graphs—one representing the economy in the long run, and the other representing the “rest of the world” economy in the long run—illustrating the effects of the reduction in government purchases on national saving and interest rates.

b) Carefully explain how each of the following are affected by the government policy:

--investment

--net exports

--user cost of capital

--capital account balance

--government savings

c) Suppose that the changes described in (b) persist for many years. Use the growth accounting equation to predict the effects of the changes on long term economic growth.

3. The Central Bank in a closed economy sells government securities in secondary markets.

- i) Use the IS-LM model to forecast the effect of this sale on interest rates, unemployment, and consumption in the short run.
- ii) Illustrate the changes using an IS-LM diagram.

4. “A tax cut causes higher spending. This should result in a boom in production that should continue for many many years”

Comment on the consistency of this claim with models discussed in class.