**Unit III FRQ Prep**

1. Be able to show a government operating at full employment/recession/inflation in short-run equilibrium (AD/AS/LRAS)
   1. Label graph correctly
   2. Label LRAS as Yf
   3. Determine equilibrium PLe and Ye (output)
2. What happens when the government utilizes the balanced budget multiplier? (raise in taxes and raise in spending?) How does that change equilibrium, output and price level? Be able to graph this change…
3. What happens if a government institutes a tariff on imports? How does this effect change at equilibrium, price level and output? Be able to graph this change…
4. Explain fiscal and monetary policies.
5. Calculate increase/decrease in government spending needed to bring about full employment when given an output and MPC.
6. Explain why decreasing taxes has a smaller effect on the economy than a change in government spending.
7. **Use the Powerpoint and pgs. 569-579 to help you prepare for this.**
   1. Be able to calculate for equilibrium GDP using data table.
   2. Be able to calculate for net exports.
   3. Identify changes to equilibrium if changes to the GDP variable occur.
   4. Calculate to find the multiplier.

**Sample Question**: The data in the first two columns below are for a private closed economy. Use this table to answer the following questions.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Real GDP = DI**  **(billions)** | **Aggregate expenditures**  **(billions)** | **Exports**  **(billions)** | **Imports**  **(billions)** | **Net**  **exports**  **(billions)** | **Aggregate expenditures**  **(billions)** |
| $100 | $120 | $10 | $15 | $\_\_\_\_\_ | $\_\_\_\_\_ |
| 125 | 140 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |
| 150 | 160 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |
| 175 | 180 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |
| 200 | 200 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |
| 225 | 220 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |
| 250 | 240 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |
| 275 | 260 | 10 | 15 | \_\_\_\_\_ | \_\_\_\_\_ |

(a) What is the equilibrium GDP for the private closed economy?

(b) Including the international trade figures for exports and imports, calculate net exports and determine the equilibrium GDP for a private open economy.

(c) What will happen to equilibrium GDP if exports were $5 billion larger at each level of GDP?

(d) What will happen to equilibrium GDP if exports remained at $10 billion, but imports dropped to $5 billion?

(e) What is the size of the multiplier in this economy?

**Sample Question Answer**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Real GDP = DI**  **(billions)** | **Aggregate expenditures**  **(billions)** | **Exports**  **(billions)** | **Imports**  **(billions)** | **Net exports**  **(billions)** | **Aggregate expenditures**  **(billions)** |
| $100 | $120 | $10 | $15 | −$5 | $115 |
| 125 | 140 | 10 | 15 | −5 | 135 |
| 150 | 160 | 10 | 15 | −5 | 155 |
| 175 | 180 | 10 | 15 | −5 | 175 |
| 200 | 200 | 10 | 15 | −5 | 195 |
| 225 | 220 | 10 | 15 | −5 | 215 |
| 250 | 240 | 10 | 15 | −5 | 235 |
| 275 | 260 | 10 | 15 | −5 | 255 |

(a) For a private closed economy, equilibrium GDP = $200 billion.

(b) For a private open economy, equilibrium GDP = $175 billion.

(c) Equilibrium GDP would return to $200 billion.

(d) Equilibrium GDP would rise to $225 billion.

(e) When aggregate expenditures change by 5, equilibrium GDP changes by 25 so the multiplier must be 5.