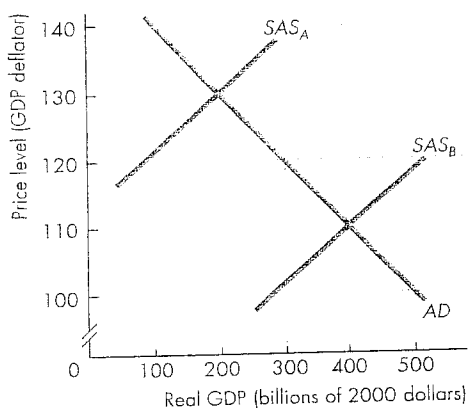


1. Suppose that in China in 2007, investment is \$400 billion, saving is \$400 billion, tax revenues are \$500 billion, exports are \$300 billion, and imports are \$200 billion.
 - a. Calculate government expenditure.
 - b. What is the government budget balance?
 - c. Is the government exerting a positive or negative impact on investment?
 - d. What fiscal policy action might increase investment and speed economic growth? Explain how the policy action would work.

2. The economy is in a boom and the inflationary gap is large.
 - a. Describe the discretionary and automatic fiscal policy actions that might occur.
 - b. Describe a discretionary fiscal restraint package that could be used that would not produce serious negative supply-side effects.
 - c. Explain the risk of discretionary fiscal policy in this situation.

6. The figure shows the economy of Freezone. The aggregate demand curve is AD , and the short-run aggregate supply curve is SAS_A . Potential GDP is \$300 billion.



- a. What are the price level and real GDP?
 - b. Does Freezone have an unemployment problem or an inflation problem? Why?
 - c. What do you predict will happen in Freezone if the central bank takes no monetary policy actions?
 - d. What monetary policy action would you advise the central bank to take and what do you predict will be the effect of that action?
7. Suppose that in Freezone, shown in problem 6, the aggregate demand curve is AD and potential GDP is \$300 billion, but the short-run aggregate supply curve is SAS_B .
- a. What are the price level and real GDP?
 - b. Does Freezone have an unemployment problem or an inflation problem? Why?
 - c. What do you predict will happen in Freezone if the central bank takes no monetary policy actions?
 - d. What monetary policy action would you advise the central bank to take and what do you predict will be the effect of that action?
8. Suppose that in Freezone, shown in problem 6, the short-run aggregate supply curve is SAS_B and potential GDP increases to \$350 billion.
- a. What happens in Freezone if the central bank lowers the federal funds rate and buys securities on the open market?
 - b. What happens in Freezone if the central bank raises the federal funds rate and sells securities on the open market?
 - c. Do you recommend that the central bank lower or raise the federal funds rate? Why?
9. Suppose that in Freezone, shown in problem 6, the short-run aggregate supply curve is SAS_A and a drought decreases potential GDP to \$250 billion.
- a. What happens in Freezone if the central bank lowers the federal funds rate and buys securities on the open market?
 - b. What happens in Freezone if the central bank raises the federal funds rate and sells securities on the open market?
 - c. Do you recommend that the central bank lower or raise the federal funds rate? Why?