

FRQ 3

1. Assume the US economy is at 4% unemployment at 5% inflation.

(a) Using a correctly labeled AS/AD graph, show the following:

(i) Full-employment output

(ii) Current output

(iii) Current price level

(b) If the government continues a high level of deficit spending, what effect will that have on the US economy?

Explain.

(c) Using a correctly labeled AS/AD graph, show how the change you identified in part (b) affects the price level and output level in the short run.

(d) What effect will the high deficit have on US interest rates? Explain.

(e) What effect will the interest change rate you identified in (d) have on the US government spending? Explain.

(f) Explain if it would be possible for the US government to indefinitely sustain high levels of deficit spending.

2. Construct a circular-flow diagram to represent the national economy, including the government sector.

(a) Draw and explain how exports and imports could be shown in the circular-flow diagram.

(b) What would happen if producers did not offer enough money for households to purchase the goods and services they produce? Explain.

3. Back in the early 70's, the US had high unemployment and high inflation.

(a) Is this possible to show on an AS/AD graph? Explain.

(b) Would fiscal policies designed to reduce unemployment reduce inflation? Explain.

(c) Which would be more important to control first, unemployment or inflation? Explain.

*For #3, you'll have to consider the differences between a AS/AD graph with no changes shown on it and an AS/AD graph with changes in either AS or AD.*