

Unit 3 Progress Check: FRQ

Name _____

1. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. If the question prompts you to “Calculate,” you must show how you arrived at your final answer.

The economy of Country X is at full employment.

(a) Draw a correctly labeled graph of the long-run aggregate supply, short-run aggregate supply, and aggregate demand curves, and show each of the following.

(i) Current price level, labeled PL_1

(ii) Current real output, labeled Y_1

(b) Assume that household income increases as a result of recent economic prosperity in Country X. On your graph in part (a), show the effect of the increase in household income on real output and price level.

(c) What will be the effect of the change identified in part (b) on unemployment in Country X?

(d) Will the change in real output shown in part (b) be smaller or larger in the presence of automatic stabilizers? Explain.



Please respond on separate paper, following directions from your teacher.

2. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes. If the question prompts you to “Calculate,” you must show how you arrived at your final answer.

The economy of Newland is in short-run macroeconomic equilibrium. The current real output is \$400 billion, and the full employment output is \$500 billion. The marginal propensity to consume is 0.8.

(a) Is the economy experiencing a recessionary output gap or an inflationary output gap? Explain.

(b) Assume Newland’s government is considering taking action to close the output gap identified in part (a).

(i) Calculate the minimum change and indicate the direction of change in government spending required to shift the aggregate demand curve to close the output gap. Show your work.



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- (ii) If instead Newland's government changes taxes without changing government spending, calculate the minimum change and indicate the direction of change in taxes required to shift the aggregate demand curve to close the output gap. Show your work.
- (c) Which fiscal policy action, changing government spending or changing taxes, is more effective in closing the output gap? Explain.
- (d) Assume instead Newland's government decides not to take any policy action. Will short-run aggregate supply increase, decrease, or stay the same in the long run? Explain.



Please respond on separate paper, following directions from your teacher.