EC 201: Principles of Macroeconomics

Worksheet-7

Q1. If policy makers want to decrease real GDP by \$100 billion and the marginal propensity to consume is 0.6, they should .... government purchases of goods and services (G) by ....

Q2. Real GDP equals \$100 billion, potential output (Y_p) equals \$160 billion, and the marginal propensity to consume is 0.75. Select the best option.

- There is an inflationary gap; to close it requires a decrease in government purchases of \$15 billion or an increase in transfers by \$20 billion.
- There is a recessionary gap; to close it requires an increase in government purchases of \$15 billion or a decrease in transfers by \$20 billion.
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Q3. The Italian government decides to stimulate the economy by sending checks worth \$70 billion to Italian consumers. If the government spending multiplier is 1.5, calculate the MPC to determine the final change in Italy's real GDP due to the transfer. Please give your answer as a whole number in billions of dollars.

Hint: Solve for MPC using Government spending multiplier= $\frac{1}{1-MPC}$. Then solve for change in GDP using the following formula: $\Delta Y = MPC \times \Delta TR \times \left(\frac{1}{1-MPC}\right)$

Q4. Determine whether the followings are *automatic stabilizers* or *discretionary spending.*

- Unemployment benefits increase during recession.
- Personal and corporate income taxes increase when economic growth is high.
- Congress decides to increase the generosity of unemployment benefits.
- New law increases healthcare spending.
- Government decides to increase taxes to fight recessionary gap

Q5. Assume MPC is 0.6. If the government reduces spending by \$10 billions, by how much will real GDP change?