Analyzing the Macroeconomy

Answer the following questions. In some cases, you may also want to include a graph to show your analysis.

1. True, false or uncertain, and explain why? "Regardless of our current economic situation, an increase in aggregate demand will always create new jobs."

2. True, false or uncertain, and explain why? "In the long run, when nominal wages increase, everyone has more money to spend; therefore, the economy as a whole benefits."

3. True, false or uncertain, and explain why? "When unemployment rises, the price level falls. When unemployment falls, the price level rises. It is impossible to have a rising price level with rising unemployment."

4. True, false or uncertain, and explain why? "Our economy is able to adjust to a long-run equilibrium after a decrease in aggregate demand because prices and wages are sticky."

5. True, false or uncertain, and explain why? "If we are in a recession, as long as we continue to increase aggregate demand, we can achieve full employment without driving up the inflation rate."

6. True, false or uncertain, and explain why? "When the economy experiences an increase in aggregate demand, it will discover that its production possibilities curve has shifted outward."

7. Use short-run AD and AS analysis to illustrate the results of the following events. Then explain why these changes have taken place. Each answer should be accompanied by a clearly labeled diagram.

   (A) There is a 25 percent decrease in the price of crude oil.

   (B) Price levels in Germany, Japan and Great Britain rise considerably, while price levels in the United States remain unchanged.

   (C) The federal government launches a major new highway-construction program.

(D) An insidious computer virus causes all IBM computers in the United States to crash.

(E) There is an increase in worker productivity.

8. Illustrate the following fiscal policy using both the AD and AS model and the Keynesian aggregate expenditure model. In other words, draw two graphs for the fiscal policy change and give a brief explanation of each graph. In your explanation, be sure to emphasize the line of reasoning that generated your results; it is not enough to list the results of your analysis.

   Fiscal Policy: At less than full employment, the federal government decreases taxes while holding government spending constant.