MACROECONOMICS
Section II
Total Time—1 hour
Reading Period—10 minutes
Writing Period—50 minutes

Directions: You are advised to spend the first 10 minutes reading all of the questions and planning your answers. You will then have 50 minutes to answer all three of the following questions. You may begin writing your responses before the reading period is over. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. 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. Use a pen with black or dark blue ink.

1. Assume the economy of Artland is currently operating above full employment.

(b) Assume the central bank and the government do not take any policy actions to close the output gap.

(i) On your graph in part (a), show how the economy automatically adjusts in the long run and label the new equilibrium price level PL_2.

(ii) Explain the cause of the adjustment shown in part (b)(i).

(c) Alternatively, suppose the government wants to close the output gap using fiscal policy.

(i) Identify a fiscal policy action the government could implement to close the output gap.

(ii) How will the fiscal policy action identified in part (c)(i) affect the following?

- The unemployment rate
- The natural rate of unemployment

(iii) In closing the output gap, will the automatic adjustment identified in part (b)(i) produce a higher, a lower, or the same price level compared to the fiscal policy identified in part (c)(i) ?

(e) Given the interest rate change identified in part (d), will the long-run aggregate supply curve shift to the right, shift to the left, or remain the same in the long run? Explain.