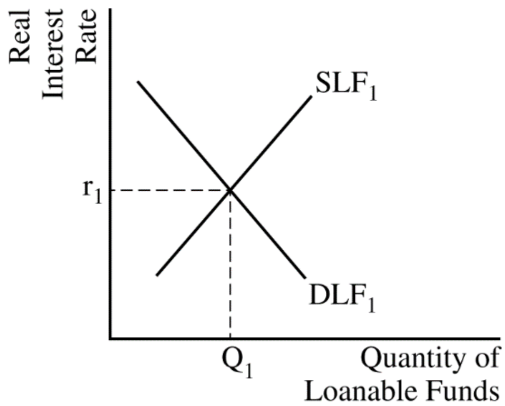
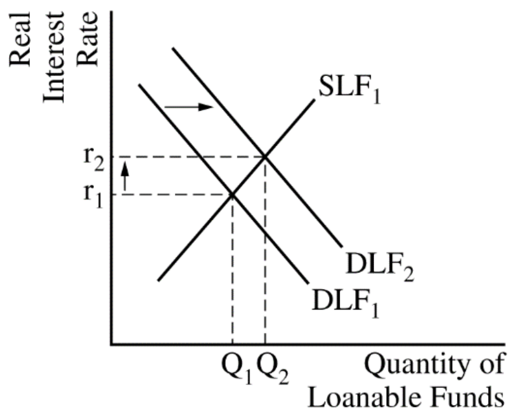
Question 2: Short — 5 points

(a) State that the country could implement one of the following fiscal policy actions: increase government spending, increase transfer payments, or decrease taxes. — **1 point**

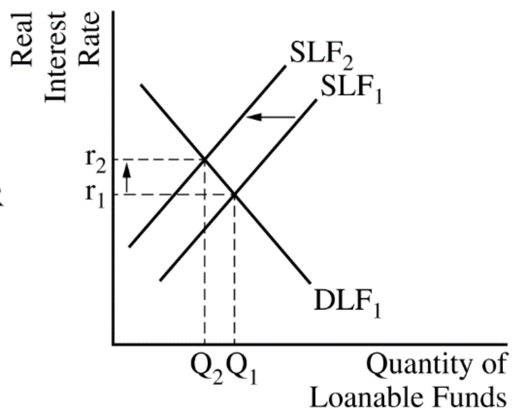
(b) Draw a correctly labeled graph of the loanable funds market. — **1 point**



For the second point, the graph must show a rightward shift in the demand for loanable funds curve (or a leftward shift in the supply of loanable funds curve), resulting in an increase in the equilibrium real interest rate. — **1 point**



OR



Total for part (b) — 2 points

(c) (i) State that net exports will decrease and explain that the increase in the real interest rate will increase the demand for the country's currency, which will cause the country's currency to appreciate and make domestic goods relatively more expensive than foreign goods, thereby decreasing exports. — **1 point**

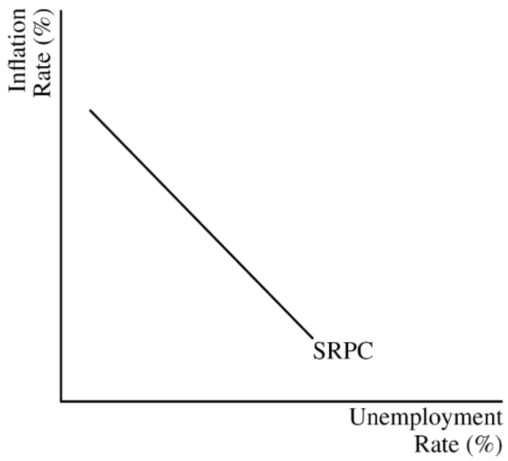
(ii) State that the stock of physical capital will decrease and explain that the increase in the real interest rate will discourage investment spending in physical capital. — **1 point**

Total for part (c) — 2 points

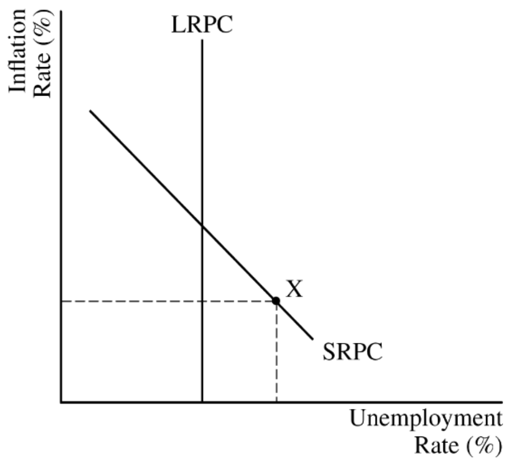
Total for question 2 — 5 points

Question 2: Short — 5 points

(a) Draw a correctly labeled graph of the SRPC. **1 point**



For the second point, the graph must include a correctly labeled LRPC and show point X on the SRPC to the right of the LRPC. **1 point**



Total for part (a) **2 points**

(b) (i) Calculate the minimum change in government spending as \$150 billion and show your work. **1 point**

$$\frac{\text{Change in GDP}}{\text{Spending Multiplier}} = \frac{\$600 \text{ billion}}{1/(1-0.75)} = \frac{\$600 \text{ billion}}{4} = \$150 \text{ billion}$$

(ii) Calculate the minimum change in taxes as \$200 billion and show your work. **1 point**

$$\frac{\text{Change in GDP}}{\text{Tax Multiplier}} = \frac{\$600 \text{ billion}}{-0.75/(1-0.75)} = \frac{\$600 \text{ billion}}{-3} = -\$200 \text{ billion}$$

Total for part (b) **2 points**

(c) Explain that SRAS will increase in the long run due to a decrease in nominal wages, input prices, or inflationary expectations. **1 point**

Total for question 2 **5 points**