2. Assume a country's economy is currently operating below full employment.

(a) Identify a fiscal policy action the country's government could implement to restore full employment.

(b) Draw a correctly labeled graph of the loanable funds market, and show the effect of the fiscal policy action identified in part (a) on the equilibrium real interest rate.

(c) Based solely on the real interest rate change shown in part (b), what will happen to each of the following?

(i) Net exports. Explain.
(ii) The stock of physical capital. Explain.

Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.

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2. Assume the economy of Ucheland is currently at full employment. The government of Ucheland reduces the tax rate on household interest earnings.

(a) What will happen to private savings in Ucheland?

(b) Draw a correctly labeled graph of the loanable funds market, and show the effect of the change in private savings identified in part (a) on the equilibrium real interest rate.

(c) Given the real interest rate change identified in part (b), answer the following questions.

(i) What is the short-run effect on aggregate demand? Explain.

(ii) What is the long-run effect on potential real gross domestic product in Ucheland? Explain.