Chapter 12 Exercises

Self-Check Questions

1. In the Keynesian framework, which of the following events might cause a recession? Which might cause inflation? Sketch AD/AS diagrams to illustrate your answers.

a. There is a large increase in the price of the homes that people own.

b. There is rapid growth in the economy of a major trading partner.

c. The development of a major new technology offers profitable opportunities for business.

d. The interest rate rises.

e. The good imported from a major trading partner becomes much less expensive.

2. In a Keynesian framework, using an AD/AS diagram, which of the following government policy choices offers a possible solution to a recession? Which offers a possible solution to inflation?

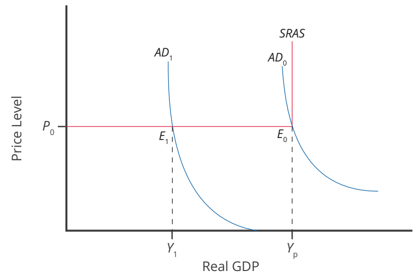
a. A tax increase on consumer income

b. A surge in military spending

c. A reduction in taxes for businesses that increase investment

d. A major reduction in what the U.S. government spends on health care outlays

3. Use the AD/AS model to explain how an inflationary gap occurs, beginning from the initial equilibrium in the following figure.



4. Suppose Congress cuts federal government spending in order to balance the fede ral budget. Use the AD/AS model to analyze the likely impact on output and employment. (*Hint*: revisit the figure in Exercise 3.)

5. How would a decrease in energy prices affect the Phillips curve?

6. Does Keynesian economics require the government to set controls on prices, wages, or interest rates?

7. List three practical problems with the Keynesian perspective.

Review Questions

8. Name some economic events, not related to government policy, that could cause aggregate demand to shift.

9. Name some government policies that could cause aggregate demand to shift.

10. From a Keynesian point of view, which is more likely to cause a recession: aggregate demand or aggregate supply? Why?

11. Why do sticky wages and prices increase the impact of an economic downturn on unemployment and recession?

12. Explain what economists mean by "menu costs."

13. What tradeoff is shown by a Phillips curve?

14. Would you expect to see long-run data trace out a stable, downward-sloping Phillips curve?

15. What is the Keynesian solution for a recession? For inflation?

16. How does the Keynesian perspective address the economic market failure of the Great Depression?

Critical Thinking Questions

17. What impact would an increase in imports from China have on the U.S. economy?

18. China's economy has grown considerably over the last several decades. If its economic growth continues, what do you think the effect would be on U.S. trade with China? What about if its economic growth slows down?

19. Does it make sense that wages would be sticky downward but not upward? Why or why not?

20. Suppose the economy is operating at potential GDP when it experiences an increase in export demand. How might the economy increase production of exports to meet this demand, given that the economy is already at full employment?

21. Do you think the Phillips curve is a useful tool for analyzing the economy today? Why or why not?

22. Return to Table B-63 (hawkes.biz/erp) from the Work It Out in this chapter. How would you expect government spending to have changed over the last six years?

23. Explain what types of policies the federal government may have implemented to restore aggregate demand and the potential obstacles policy makers may have encountered.