FRQ 7.5

1. In 1933, the US was in an awful depression. Unemployment was very high and prices were very low. Government spending was almost non-existent and both exports and imports were negligible due to worldwide high tariffs.

(a) Using a correctly labeled AS/AD graph, show the equilibrium output of the US in 1933.

(b) Identify three possible monetary policies that could be used to boost aggregate demand.

(c) Identify two possible fiscal policies that could be used to boost aggregate demand.

(d) If the nation remains on the gold standard, which monetary policies will be difficult or impossible to put into place? Explain your answer.

(e) The US government has chosen to increase spending dramatically, while increasing taxes on the wealthy and increasing transfer payments to the poor.
- (i) Using a correctly labeled AS/AD graph, show the change in equilibrium output of the US and the change in the price level.
- (ii) How will the US government policy affect overall consumption? Explain.
- (iii) How will the US government policy affect interest rates? Explain.
- (iv) How will the US government policy affect gross investment? Explain.
- (v) How will the US government policy affect net exports? Explain.

(f) How would worldwide dismantling of trade barriers change the situation? Explain.

2. During the late 1990's, due to an asset boom that fueled a speculative bubble, the US economy operated for a time beyond the full-employment output line.

(a) Using a correctly labeled AS/AD graph, show the equilibrium output of the US in the late 1990's.

(b) In 2001, the asset boom collapsed and many companies it had created went bankrupt.
- (i) How would that affect aggregate supply?
- (ii) How would that affect aggregate demand?
- (iii) Would these changes involve a return to the LRAS line? Explain.
- (iv) Using a correctly labeled AS/AD graph, show the new equilibrium output of the US in 2001.
- (v) Are there any fiscal or monetary policies that could return the US economy to the level of output it experienced in the late 1990's? Explain.

(c) In 2003, worldwide oil prices increased dramatically. This acted as an overall tax on the economy.
- (i) How would that affect aggregate supply?
- (ii) How would that affect aggregate demand?
- (iii) Using a correctly labeled AS/AD graph, show the new equilibrium output of the US in 2004.

(d) The US government cut taxes and dramatically increased spending during this time. Using a correctly labeled AS/AD graph, show the new, *new* equilibrium output of the US in 2004.
- (i) If the Federal Reserve also raised the discount rate during this time, how were interest rates affected overall? Explain.
- (ii) How would the interest rate change you identified in (d)(i) affect gross investment and net exports? Explain.