

Problem Set #4

Due Friday 4/7/06 by 6 p.m. in the Econ 101 slot in the Economics Alcove

Use a stapler! Write legibly and use full and grammatically correct sentences in your answers. Draw graphs neatly and label axes and points clearly. Each part below is weighted equally in grading, as are subparts within a part.

- A. 1) In each of the following cases, state your example clearly and explain why it is a good example for the category.
- a. Give an example of a private good.
 - b. Give an example of a club good.
 - c. Give an example of a common good.
 - d. Give an example of a public good.
- 2) a. Do Problem 3 on pp. 438-439 in Chapter 20.
- b. Do Problem 4 on p. 439 in Chapter 20.
 - c. Do Problem 5 on p. 439 in Chapter 20.
 - d. Do Problem 6 on p. 439 in Chapter 20.
- B. Explain and illustrate the following by shifts in either or both the aggregate demand and supply curves. Pay attention to the initial position before the shift(s) occurs.
- 1) Output and employment rise, while prices hold steady.
 - 2) Prices soar, but employment and output hold steady.
 - 3) Inflation accelerates even as the recession actively deepens.
 - 4) In 1979-80 the British government greatly reduced income taxes, but restored the lost government revenue by raising excise and sales taxes. This led to a short burst of extra inflation and a fall in employment and output.

C. Consider the data on real GDP and the price level in the following table:

Year	Real GDP (Billions of \$, 1987 prices)	Price level (GDP deflator, 1987 = 100)
1980	3776	71.7
1981	3843	78.9
1982	3760	83.8
1983	3907	87.2
1984	4149	91.0
1985	4280	94.4
1986	4405	96.9
1987	4540	100.0
1988	4719	103.9
1989	4838	108.5
1990	4897	113.3
1991	4861	117.7
1992	4986	121.1
1993	5133	124.2

- 1) For the years 1981 to 1993, calculate the rate of growth of real GDP and the rate of inflation. In which years were there recessions? Which year had the worst recession during this period?
- 2) In an AS-AD diagram, draw a set of AS and AD curves that would trace out the price and output equilibria shown in the table for the years 1988 through 1993. How would you explain the recession that occurred during this period?

D. Indicate for each of the following events whether it is a cause or a consequence of a shift in aggregate demand or supply. If it is a cause, illustrate the situation before and after the event and predict the effect on the price level and on real national income. If it is a consequence, discuss what could have caused the event and illustrate the situation using the AS-AD framework.

- 1) In the late 1960s and early 1970s, the United States suffers a rapid inflation under conditions of approximately full employment.
- 2) The Persian Gulf War disrupts oil shipments in 1991.
- 3) President Bush pushes a large increase in defense spending in 2002-2006.
- 4) New Orleans is largely submerged by flooding in 2005.