Chapter 25

Put into practice questions

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If your government were to think that the economy was in a recession, what type of policies would it adopt?

Expansionist fiscal and monetary policies.

End of chapter put into practice questions

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A recession may be caused by a fall in aggregate demand. Show how a fall in aggregate demand leads to a fall in national income using a diagram.

A fall in aggregate demand shifts the demand inwards; this should lead to lower prices and a lower output.

Outline the actions a government might take to help an economy recover from a recession. Illustrate this with a diagram.

It might reduce taxes or increase government spending. Its central bank might reduce interest rates. These policies will increase aggregate demand. Aggregate demand shifts outwards.

Show the difference between growth in actual output and growth in potential output using a production possibility frontier.

Growth in potential output is shown by a shift outwards of the PPF
Growth in actual output can be a move from within the frontier on to the frontier.

What is meant by a negative output gap?

Answer is B: actual output is below potential output

Which of the following is most likely to result from a growing negative output gap?

Answer is D: a rise in welfare spending by the government.

Show how an increase in productivity might affect aggregate supply.

Increases aggregate supply and shifts this outwards

Show how an increase in investment might affect aggregate demand and aggregate supply.
Increase aggregate demand as more demand for capital goods. Over time greater technology and capacity increase aggregate supply.

Use an externality diagram to show the welfare loss if the social costs of producing are greater than the private costs.

See figure 8.7