Econ 116
Problem Set 2
Due September 20, 2016

1. What happens to the economy if actual investment is greater than planned investment?

2. What is the marginal propensity to save? How is the multiplier affected by it?

3. Explain carefully the difference between an endogenous variable, an exogenous variable, and a parameter or coefficient. Give an example of each as used in class. If parameters are chosen by the procedure of least squares, what does this mean? What if least absolute deviations was used instead?

4. Why would a balanced budget amendment increase the size of the government spending multiplier?

5. Consider the model $C = b(Y - T)$, $T = tY - TR$, $Y = C + I + G$, where C is consumption, I is planned investment (exogenous), G is government spending (exogenous), Y is output, T is net taxes, t is the tax rate (exogenous), and TR is the value of transfer payments (exogenous). b is the marginal propensity to consume. Assume that $b = .75$ and $t = 1/3$. How much does Y increase when G increases by 10? How much does Y increase when TR increases by 10? Explain carefully why these two multipliers are not the same—what is the intuition?

6. In the above question, how much will the government deficit increase if G is increased by 10? How much will it increase if TR is increased by 10?

7. What was the size of the federal government deficit (at an annual rate) in each of the quarters 2015:3–2016:2?