

3. How does each of the following changes affect the real gross domestic product and price level of an open economy in the short run? Explain each.
- (a) An increase in the price of crude oil, an important natural resource
 - (b) A technological change that increases the productivity of labor
 - (c) An increase in spending by consumers
 - (d) The depreciation of the country's currency in the foreign exchange market

OUTPUTS AND PRICES IN GALA LAND

This Year's Output	This Year's Price
400 loaves of bread	\$6 per loaf
1,000 gallons of water	\$2 per gallon
800 pieces of fruit	\$2 per piece

3. Gala Land produces three final goods: bread, water, and fruit. The table above shows this year's output and price for each good.
- (a) Calculate this year's nominal gross domestic product (GDP).
 - (b) Assume that in Gala Land the GDP deflator (GDP price index) is 100 in the base year and 150 this year. Calculate each of the following.
 - (i) The inflation rate, expressed as a percentage, between the base year and this year
 - (ii) This year's real GDP
 - (c) Since the base year, workers have received a 20 percent increase in their nominal wages. If workers face the same inflation that you calculated in part (b)(i), what has happened to their real wages? Explain.
 - (d) If the GDP deflator in Gala Land increases unexpectedly, would a borrower with a fixed-interest-rate loan be better off or worse off? Explain.
1. Suppose that the United States economy is in a deep recession.
- (a) Using a correctly labeled aggregate demand and aggregate supply graph, show the equilibrium price level and real gross domestic product.
 - (b) There is a debate in Congress as to whether to decrease personal income taxes by a given amount or to increase government purchases by this amount. Which of these two fiscal policies will have a larger impact on real gross domestic product? Explain.
 - (c) Explain how a decrease in personal income taxes will affect each of the following in the short run.
 - (i) Consumption
 - (ii) Real gross domestic product and the price level
 - (iii) Imports
 - (iv) Exports
 - (d) Explain the mechanism by which an increase in net investment will cause each of the following to change.
 - (i) Aggregate demand
 - (ii) Long-run aggregate supply