

Macroeconomics 1 (A European Perspective)

Week 5

Utrecht School of Economics
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1. **Strategies for (medium run) growth.** During the lecture we discussed potential (government) strategies for growth in the medium run.
 - (a) Explain—by applying the IS-LM-PC model—how fiscal and monetary policies do not lead to an increase of economic growth in the long run.
 - (b) Which supply-side strategies do lead to long run growth, according the IS-LM-PC model?
 - (c) Compare the outcome in (a) and (b) for economic strategies with real-world economic policies in the last decades. Do you recognise the logic of the model in actual policies?
 - (d) Discuss the limitations of the model: Do you agree to draw conclusions for economic strategies, based on such model?

Problem set

2. A natural experiment: The effect of an increase in the minimum wage.

Read the following article on the 2021 Nobel prize in economic sciences and answer the questions: <https://www.nobelprize.org/uploads/2021/10/popular-economicsciencesprize2021-3.pdf> (untill ‘Local average treatment effect’).

- (a) Explain why experiments cannot be constructed for most (macro) economic research issues.
- (b) Explain how these Nobel Laureates applied the natural experiments.
- (c) Which conclusions can be drawn from the ‘The association between education and income’ figure?
- (d) The article states that ‘In the early 1990s, the conventional wisdom among economists was that higher minimum wages lead to lower employment’. Is this in line with our models?

Problem set

- (e) What was the Card and Krueger conclusion on the relation between an increase in minimum wage and demand for labour?
- (f) What could be the reason for this conclusion, what could be wrong with our model?

Problem set

3. Read the following article (The economist, Nov 25th 2021) and answer the questions.
- (a) Explain how inflation could be ‘homegrown’ and relate this to the IS-LM-PC model!
 - (b) Explain how inflation could be ‘global’ and relate this to the IS-LM-PC model.
 - (c) It is suggested in the article that the Fed (the US Central Bank) should respond differently in case the cause of inflation is homegrown other than global. Explain the difference.

Problem set

4. Below you will find the text of an article from the Economist (November 2022). Read the text and answer the related questions.
- (a) The title of the article is ‘Prepare for the rising tension between fiscal and monetary policy’. Explain the title. What is exactly the tension and what is the cause of the tension?
 - (b) The article refers to Italy as a country that might experience the mentioned conflict between fiscal and monetary policy. Why does the article refer to Italy, what’s the specific problem for Italy?
 - (c) The article states that ‘in emerging markets the challenge is coping with a tightening Fed.’ Explain why emerging markets suffer from the Fed policy!

Questions?