

THE UNIVERSITY OF ILLINOIS AT CHICAGO
ECON 333: INTERNATIONAL ECONOMICS
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Your name: _____

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Homework 2: An Application on the Keynesian model

Consider the following data for the United Kingdom and Italy:

Year	U.K. (billions of £)					Italy (trillions of lire)		
	GDP	C	G	EX	IM	GDP	C	IM
1995	699.6	448.2			203.1	1787.3	1041.9	410.5
2000	934.9	611.7	174.8	254.4	272.2	2256.8	1353.1	614.5

Assume that the £/LR exchange rate is fixed and there is no capital mobility. (a) Calculate the marginal propensities to consume and import for both economies for the 1995-2000 period (treat the U.K. as the domestic economy).

Suppose government downsizing in the U.K. reduces G to £164.8 billion. (b) Suppose the U.K. is a closed economy. How will the downsizing affect output?

(c) Suppose now the U.K. is a small open economy. What will be the effects of the downsizing on U.K. output and the U.K. trade balance?

(d) Now assume the entire world consists of the U.K. and Italy, and both are large, open economies. What will be the effects on U.K. and Italian output levels? (The 2000 exchange rate was approximately LR3,500/£).