

Intermediate Economics B

Problem Set 9

1. Suppose an open economy is initially in a recession. Explain how process by which real exchange rate depreciation will move the economy back to full employment over the medium term. Explain how this process can be accelerated by a nominal devaluation.
2. Explain the problems associated with a flexible exchange rate regime.
3. Consider the production function $Y = K N$.
 - (a) Compute output when $K = \sqrt{49}$ and $N = \sqrt{81}$.
 - (b) If both capital and labour double, what happens to output?
 - (c) Is this production function characterised by constant returns to scale? Explain.
 - (d) Write this production function as a relation between output per worker and capital per worker.
 - (e) Let $K/N = 4$. What is Y/N ? Now double K/N to 8. Does Y/N double as a result?
 - (f) Does the relation between output per worker and capital per worker exhibit constant returns to scale?
 - (g) Is your answer in (f) the same as your answer in (c)? Why or why not?
 - (h) Plot the relation between output per worker and capital per worker. Does it have the same general shape as the relation in Figure above? Explain.

