

Econ 261
Pernecky
Spring 1996

Exam 1

Pledge: "I pledge my honor that during this examination I have neither given nor received assistance, and that I have seen no dishonest work."

Signed

Name

On the graphs, be sure to label all axes, curves, and initial and concluding equilibrium values where relevant.

On multiple choice question, circle the letter of the best answer.

The number of points each question is worth out of a total of 200 points is indicated by ()s next to each question.

(30) 1. (a) What assumptions are made in the Classical Quantity Theory of Money, and how are these assumptions altered when generating a Classical Aggregate Demand Curve?

(55) 2. (a) Graphically depict the complete classical model, ie. the labor market, production function, aggregate demand diagram, and loanable funds market.

(b) Alter your diagram(s) in (a) to depict what would have occurred had the velocity been lower. **Do not draw new diagrams here.**

(30) 3. (a) Define, "structural unemployment".

(b) According to Classical economists, why should structurally unemployed workers be considered voluntarily unemployed? Utilize the definition of voluntary unemployment in your answer.

(c) Provide one explanation a Keynesian might give for identifying a structurally

unemployed worker during the Great Depression as involuntarily unemployed.

(5) 4. Say's Law holds, according to Classical economists, because:

- a. income adjusts to equate savings and investment
- b. aggregate demand determines output, and thus employment
- c. factor costs do not include profits (dividends)
- d. none of the above

(5) 5. The Classical production function exhibits _____ returns and a _____ marginal product.

- a. decreasing (diminishing), positive
- b. increasing, positive
- c. decreasing (diminishing), negative
- d. increasing, negative

(5) 6. According to Keynes, an increase in investment should result in:

- a. a decrease in consumption
- b. a decrease in savings
- c. an increase in labor demand
- d. none of the above

(5) 7. According to the Classical Model,

- a. the real wage equals the marginal product of labor
- b. the real wage equals the marginal revenue product of labor
- c. the nominal wage equals the marginal product of labor
- d. none of the above

(50) 8. (a) Solve the following Classical Model, ie. find the equilibrium values, for the endogenous variables below.

$$Y = 90 + N$$

$$N_d = 150 - 2(W/P)$$

$$N_s = 50 + 3(W/P)$$

$$N_d = N_s$$

$$P = MV/Y$$

where $M = 200$, and $V = 2$

$$I = 10 - 2r$$

$$S = 4 + r$$

$$I = S$$

where Y is real output, N_d is labor demand, N_s is labor supply, W/P is the real wage, W is the nominal wage, M is the money supply, V is velocity, P is the price level, I is investment, r is the interest rate, and S is savings.

(W/P)

N

Y

P

r

I

S

(b) Graphically depict the Classical model with the equilibrium values (numbers) indicated.

(5) 9. According to the Classical Model, if the money supply were to double, the price level would:

- a. rise but not double
- b. not change
- c. fall
- d. double

(5) 10. According to Classical economists, the imposition of an effective minimum wage or union on a labor market:

- a. increases involuntary unemployment
- b. increases voluntary unemployment
- c. reduces involuntary unemployment
- d. reduces voluntary unemployment

(5) 11. According to Keynes, if interest rates are low, bond prices are expected to _____, so the amount of money demanded is _____.

- a. rise, low
- b. rise, high
- c. fall, low
- d. fall, high

DID YOU REMEMBER TO CONSIDER THE PLEDGE?