

Final

Please use the pledge on the blue book and put your name on the blue book. Show all your work in the blue book.

1. Cross-sectionally, ie. for a given time period across the population, why do families with more income have a lower average propensity to consume according to: (a) the Life Cycle Hypothesis, and (b) the Permanent Income Hypothesis?
2. According to Keynes, why is investment so unstable?
3. How does Tobin's view of why people hold money differ from Keynes' view?
4. Assume that the required reserve ratio is .20 and the balance sheet below shows the effect of an open market operation in which a \$1,000 U.S. government bond was bought from a securities dealer. Assume the securities dealer deposited the \$1,000 in Bank A.

Assets		Bank A	Liabilities	
Reserves	\$ 1,000		Demand Deposits	\$ 1,000
Total	\$ 1,000		Total	\$ 1,000

- (a) What do required reserves equal?
 - (b) What do excess reserves equal?
- Now assume that Bank A makes a loan equal to all of its excess reserves to Mr. Brown, who writes a check for this amount to Ms. Jones. Assume Ms. Jones deposits this check in Bank B.
- (c) So far, how much has M1 increased because of the initial injection?
 - (d) How much are total deposits at Bank A now?
 - (e) How much are total reserves at Bank A now?
 - (f) According to the money multiplier, how much M1 will eventually be created from the initial injection of \$1,000?
5. According to the time series, the short run average propensity to consume is not constant, ie. an increase in disposable income will be associated with a decline in the average propensity to

consume. Explain why this is so according to (a) the Relative Income Hypothesis, (b) the Permanent Income Hypothesis.

6. Given the following structural equations:

$$(1) Y = C + I + G$$

$$(2) C = a + b(Y - T)$$

$$(3) T = t_0 + t_1 Y$$

where Y: Income, C: Consumption, I: Autonomous Investment, G: Autonomous Government Spending, a: Autonomous Consumption, b: Marginal Propensity to Consume, T: Taxes, t_0 : Autonomous Taxes, t_1 : Marginal Tax Rate on Income

and the values: $a = 75$, $b = .50$, $t_0 = -50$, $t_1 = .50$, $I = 100$, $G = 400$

(a) How much is the autonomous spending multiplier?

(b) How much is the equilibrium income level?

7. Other than selling government securities, name two ways the Federal Reserve Board can increase the money supply.

8. (a) Identify 1 reason why the Federal Reserve Board should remain at least as politically independent as it is.

(b) Identify 1 reason why the Federal Reserve Board should be less politically independent.

9. (a) Identify 2 tenets of Reaganomics.

(b) Why would Supply-siders support these 2 tenets?

(c) Assess these 2 tenets from the empirical evidence of the 1980s.

10. According to the Public Choice view, what relative weight do voters place on each of the following in making their voting decisions and why? (a) the unemployment rate, (b) the inflation rate, and (c) the rate of growth of real output.

11. (a) Identify 2 positive characteristics of a budget deficit.

(b) Identify 2 negative characteristics of a budget deficit.

12. Graphically depict a diagram of the U.S. demand for and supply of foreign exchange. The vertical axis should depict the exchange rate of Japanese yen in terms of U.S. dollars. Demonstrate what would occur if the Japanese demand for U.S. goods and assets were to increase. Be sure to label the initial and concluding equilibrium values.