

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

Use the blue book to answer the following questions.

(1) Identify 3 difficulties in saying that real GNP is an accurate measure of economic activity or welfare.

(2) Solve the following classical model for the equilibrium values of  $(w/p)$ ,  $N$ , and  $Y$ .

production function (1)  $Y = 20 + N$

labor demand (2)  $N_d = 50 - (w/p)$

labor supply (3)  $N_s = 10 + 4(w/p)$

where  $Y$  is national income,  $N$  is employment,  $(w/p)$  is the real wage,  $N_d$  is labor demand, and  $N_s$  is labor supply.

(3) Assume that welfare benefits improve so that workers prefer more leisure and less work at each  $(w/p)$  level. The labor supply equation changes so that the classical model in question (2) becomes

production function (1)  $Y = 20 + N$

labor demand (2)  $N_d = 50 - (w/p)$

labor supply (3)  $N_s = 5 + 4(w/p)$

(a) What are the new equilibrium values of  $(w/p)$ ,  $N$  and  $Y$ ?

(b) Are each of these equilibrium values greater than, equal to, or less than the equilibrium values in question (2)?

(4) Given the following Income/Expenditure model:

consumption function (1)  $C = a + bY_d$  where  $a = 400$ , and  $b = .9$

investment (2)  $I = I$  where  $I = 200$

government expenditures (3)  $G = G$  where  $G = 300$

equilibrium (4)  $Y = E$

taxes (5)  $T = T$  where  $T = 100$

disposable income (6)  $Y_d = Y - T$

where  $C$  is consumption,  $a$  is autonomous consumption,  $b$  is the MPC,  $Y_d$  is disposable income,  $I$  is investment,  $G$  is government spending,  $E$  is expenditures (aggregate demand),  $T$  is taxes, and  $Y$  is income,

(a) solve the model for equilibrium income,  $Y_e$ .

(b) determine how much equilibrium income would increase by if taxes were to rise by \$100?

(5) Graphically depict for the Classical Model what the impact of the recently rejected federal budget proposal would have been (ie. of a fall in government spending and a rise in taxes) in the (a) loanable funds market, (b) the labor market, (c) the production function, (d) and the aggregate demand and aggregate supply diagram. Remember to label your curves, axes, and initial and concluding equilibrium values.

(6) Graphically depict for the Keynesian Income/Expenditure Model what the impact of the recently rejected budget proposal would have been (ie. of a fall in government spending and a rise in taxes). Remember to label your curves, axes, and initial and concluding equilibrium values.

(7) Graphically depict what occurs in (the Keynesian) money market when there is an increase in the money supply. Remember to label the curves, axes, and initial and concluding equilibrium values. Why does the interest rate change?

(8) In the following IS-LM diagram, state whether there is equilibrium, excess supply, or excess demand in the money market, and in the commodities market,

(a) for point A

and (b) for point B