

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 _____

Be sure to label all axes, curves, and equilibrium values where relevant.

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

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

(70) 1. Given the following Classical Model

(1) $Y = 186 + N$

(2) $N^S = 10 + 2(W/P)$

(3) $N^d = 12 + (W/P)$

(4) $N^d = N^S$

(5) $P = MV/Y$ where $V = 2$, and $M = 400$

(6) $I = 480 - 10r$

(7) $S = 200 + 30r$

(8) $I = S$

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

(a) solve the model for the equilibrium values of

N _____

W/P _____

Y _____

P _____
W _____
r _____
I _____
S _____

(b) Graphically depict the Classical Model ie. the labor market, the production function diagram, the loanable funds market, and the aggregate demand diagram, with the equilibrium values you found in 1(a).

(c) Assume that preferences for work change such that the labor supply decreases, ie., at every real wage the amount of labor supplied is lower. Alter your diagram(s) in 1(b), ie do not draw new diagrams below, to show the impact of a decrease in labor supply. Be sure to label the new equilibrium points, although there is not enough information to know the new equilibrium values.

(5) 2. The production function in the Classical Model in its general form (ie. not in the specific Classical Model in question 1), displays:

- a. increasing returns throughout
- b. decreasing returns throughout

- c. negative returns throughout
- d. decreasing returns, then increasing returns

(5) 3. According to the Quantity Theory of Money,

- a. changes in the money supply are caused by changes in prices
- b. velocity is unstable
- c. a change in the money supply would cause a change in nominal output
- d. an increase in the money supply will cause the price level to fall by the same multiple

(5) 4. Which of the following is an exogenous variable in the Classical Model?

- a. the money supply
- b. the price level
- c. real output
- d. the nominal wage

(5) 5. Search unemployment, in which a worker quits one job to look for another which pays better, is considered by Classical economists to be

- a. structural unemployment
- b. involuntary unemployment
- c. frictional unemployment
- d. seasonal unemployment

(45) 6. (a) Why would Classical economists consider the unemployment created by the imposition of an effective minimum wage to be strictly voluntary unemployment? Include a definition of voluntary unemployment in your answer, and explain why a minimum wage yields only voluntary unemployment for Classicals.

(b) Why would Keynes argue that the unemployment created by the imposition of an effective minimum wage should be considered involuntary? Include a definition of involuntary unemployment in your answer, and utilize Keynes' views on the repercussions of cutting wages in your answer.

(5) 7. Which of the following is part of a component of aggregate demand, for Keynes?

- a. autonomous consumption
- b. gross exports
- c. business fixed investment
- d. all of the above

(15) 8. Graphically depict the impact of a reduction in national income in a Keynesian money market.

(5) 9. Which of the following is involved in firm's investment decisions, according to Keynes?

- a. uncertainty
- b. perfect knowledge
- c. probabilistic knowledge
- d. none of the above

(15) 10. Why, for Keynes, is investment a negative function of the interest rate?

(5) 11. Autonomous consumption would be expected to fall if

- a. interest rates fell
- b. inflation were expected to increase
- c. consumer confidence rose
- d. none of the above

(5) 12. Which of the following is an empirical regularity in the time series data concerning the average propensity to consume?

- a. it tends to rise in the long run
- b. it tends to fall as income rises in the short run
- c. it tends to be constant in the short run
- d. none of the above

(15) 13. Graphically depict a Consumption Function where the average propensity to consume is less than 1.

DID YOU REMEMBER TO CONSIDER THE PLEDGE?