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Econ 61  
Spring 1992

Exam 2

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

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

1. "In the expansion during the 1980s, firms took on increasing amounts of debt, in part because of enhanced expected profitability from the investment it financed." Graphically depict this statement in a single diagram using an investment demand curve and a supply of finance curve.

2. During the early 1980s, the fiscal/monetary policy mix included: (1) tax cuts on personal income, (2) tax cuts which encouraged business investment, (3) government spending increases for the military, and

(4) tight money (ie. a reduction in the money supply).

Graphically depict **and describe** the impact of each of these tax cuts, the government spending increase, and the reduction in the money supply, which in total produced an overall expansionary effect for income, for: (a) the money market, (b) a single injections/leakages diagram, and (c) a single IS/LM diagram.

d. Briefly describe the effectiveness of both this fiscal and monetary policy in regards to the IS/LM diagram if Monetarist assumptions concerning the sensitivity of investment and money demand to the interest rate are utilized as opposed to Keynesian ones.

3. An automatic (built-in) stabilizer such as progressive income tax rates

- a. reduces the cyclical deficit in recessions
- b. reduces the structural deficit in recessions
- c. increases the cyclical deficit in recessions

d. increases the structural deficit in recessions

4. In which of the following years were tax cuts used to stabilize the economy?

- a. 1948
- b. 1957
- c. 1964
- d. 1968

5. According to the balanced budget multiplier, if government spending and taxes rise by the same amount

- a. income will fall by the change in taxes
- b. income will rise by the change in taxes
- c. income will not change
- d. none of the above

6. Graphically depict the impact of an increase in the demand by Americans for Japanese electronics in (a) the market for foreign exchange, where the exchange rate is expressed as yen in terms of dollars, (b) a single injections/leakages diagram, (c) a single income/expenditure diagram.

7. The "twin deficits" refers to

- a. the trade deficit and the deficit on current account
- b. the deficit on current account and the deficit on capital account
- c. the trade deficit and the deficit on capital account
- d. the trade deficit and the federal budget deficit

8. If taxes and transfers are autonomous, the marginal propensity to save is .4, the marginal propensity to invest is .1, and the marginal propensity to import is .1, what is the government spending multiplier?

**Did you remember to consider the pledge?**