

Final Exam

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 _____

I have intentionally not signed the pledge _____
(check only if appropriate)

When drawing graphs, label all equilibrium values, axes, and curves, 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 350 points is indicated in ()s next to each question.

(20) 1. Graphically utilize an IS/LM diagram to show why Monetarists believe that activist fiscal policy in the form of increasing government spending is not very effective at altering output.

(7) 2. According to Keynesians,

- a. investment tends to be very sensitive to the interest rate
- b. the demand for money tends to be very sensitive to the interest rate
- c. both a and b
- d. neither a nor b

(7) 3. According to Monetarism,

- a. investment tends to be very sensitive to the interest rate
- b. the demand for money tends to be very sensitive to the interest rate
- c. both a and b
- d. neither a nor b

(7) 4. Which of the following is a Classical influence on Monetarism?

- a. the aggregate production function
- b. aggregate demand based on the quantity theory of money
- c. both a and b
- d. neither a nor b

The next 2 questions refer to the following scenario:

In 1998, because of the Asian financial crisis, the Federal Reserve Board engaged in a loose monetary policy (increasing the money supply) which initially reduced the federal funds rate by 1/4 percent. There had been no change in monetary policy for a number of quarters before the loosening. Under similar circumstances of international financial crises, the Federal Reserve Board had always engaged in this same monetary policy. Graphically depict the impact of this initial loosening on the following diagrams in the *short run* according to:

(55) 5. Monetarism,

- a. the labor market diagram

b. the aggregate production function diagram

c. the Phillips Curve diagram

d. the Aggregate Demand/Aggregate Supply diagram

(55) 6. Rational Expectations theory,

a. the labor market diagram

b. the aggregate production function diagram

c. the Phillips Curve diagram

d. the Aggregate Demand/Aggregate Supply diagram

(7) 7. According to Rational Expectations theory, which of the following will change in the long run when there is a price surprise?

- a. the price level
- b. output
- c. employment
- d. all of the above

(7) 8. Workers who base their price forecast for next period on this period's price level are said to have

- a. progressive expectations
- b. rational expectations
- c. perfect expectations
- d. adaptive expectations

(7) 9. The Classical Model assumes

- a. progressive expectations
- b. rational expectations
- c. perfect expectations
- d. adaptive expectations

(7) 10. According to Monetarist theory, the real wage is predicted to be

- a. procyclical
- b. acyclical
- c. countercyclical
- d. both a and b

(7) 11. According to Milton Friedman, a theory should *not* be judged by

- a. the realism of its assumptions
- b. its logical consistency
- c. its ability to predict
- d. its ability to generalize

(7) 12. Which of the following is *not* borrowed from Classical theory by Rational Expectations theory?

- a. the aggregate production function
- b. aggregate demand based on the quantity theory of money
- c. continuous market clearing (perfectly flexible prices)
- d. rational expectations

(7) 13. According to Real Business Cycle theory, a reduction in oil exports to the U.S. by OPEC countries would cause an increase in

- a. employment
- b. output
- c. the marginal product of labor
- d. none of the above

(7) 14. Real Business Cycle theory predicts that the real wage is

- a. procyclical
- b. acyclical
- c. countercyclical
- d. both b and c

(65) 15. In 1994, President Clinton's proposed income tax rate increase went into effect. Graphically depict the impact of an income tax rate increase on the following diagrams according to Supply Side Economics:

a) the labor market diagram

b) the loanable funds market diagram

c) the production function diagram

d) the Aggregate Demand Curve diagram

e) the Laffer Curve

(7) 16. Which of the following administrations tended to rely on automatic stabilizers?

- a. Regan
- b. Nixon
- c. Kennedy
- d. Eisenhower

(7) 17. Which of the following is associated with New Keynesian Theory?

- a. continuous market clearing
- b. all unemployment as voluntary unemployment
- c. aggregate demand based on the quantity theory of money
- d. none of the above

(7) 18. Which of the following efficiency wage rationales is based on the idea that a wage cut will reduce work effort by lowering the opportunity cost of dismissal?

- a. adverse selection
- b. shirking
- c. gift exchange
- d. relative wages

(57) 19. Graphically depict the impact of a reduction in government spending and a reduction in the money supply on each of the following diagrams according to Keynesian theory. Be sure to show the impact of *each* policy change in these diagrams.

a) a single IS/LM diagram

b) a single labor market diagram

c) a single Aggregate Supply Curve diagram

d) a single short run Phillips Curve diagram

DID YOU REMEMBER TO CONSIDER THE PLEDGE?