

**Final Examination
Economics 121 C & F
Prof. A. D. Becker
St. Olaf College
May 2003**

Instructions:

You will have two hours to complete this exam.

The use of books is prohibited though you may use two sheets of notes. You may also use a calculator, pencils, pens, etc. All other materials are to be out of reach and out of sight.

Both “show your work” and “explain” are part of every question even if not explicitly stated.

Answer only on the blank sheets provided.

Write only on **one side** of each page and begin each question on a new page. Leave a margin at the top so that the staple does not obscure your work.

When you have finished, staple these pages to your answers as a coversheet.

Have a good summer!

Pledge:

I pledge my honor that during this quiz I neither gave nor received assistance and that I saw no dishonest work.

Signed: _____

I have not signed the pledge intentionally. (Check only if appropriate.)

Question	Possible Points	Score
1	15	
2	10	
3	20	
4	10	
5	10	
6	20	
Total	85	

1. (15 points) In the U.S. economy, suppose that the aggregate consumption function is:

$$C = 0.80 Y$$

Private investment (I), government purchases of goods and services (G), and net exports (NX) total \$2,000 billion. Suppose that there are no taxes ($T=0$).

- Is equilibrium national income equal to, above, or below \$10,000? Explain.
- What is the numerical value of the simple multiplier for expenditures such as investment and government purchases?
- Suppose that economists estimate that exports will rise by \$30 billion due to a “weak” dollar. By how much would equilibrium national income change if prices do not change?

2. (10 points) Use the information below to answer this question.

Year	Federal Minimum Wage (hourly)	Consumer Price Index (CPI)
1940	\$0.30	14.0
1976	\$2.30	56.9
1997	\$5.15	160.5
2003	\$5.15	183.8

(The 2003 value of the CPI is for April 2003)

Sources: U.S. Department of Labor and Bureau of Labor Statistics

- In which year was the *purchasing power* of the minimum wage the highest? Explain.
- What is the amount of the minimum wage for 1976 in *today's dollars*?
- The federal minimum wage was raised to \$5.15 in 1997. Since then, how much purchasing power has a minimum wage worker lost? (You can express your answer as a percentage, in today's dollars, or in real dollars.)

3. (20 points) It was reported this week that between March and April consumer prices fell from 184.2 to 183.8, an annual rate of deflation of 2.6%. It was reported last week that unemployment had risen from 5.8% in March to 6.0% in April. The drop in the CPI was due mostly to a drop in energy prices.

- Use an aggregate demand-aggregate supply graph to explain how this might happen from a Keynesian perspective.
- Use an aggregate demand-aggregate supply graph to explain how this might happen from a Classical perspective.
- In response to the news about the CPI, major stock market indices fell sharply. (While the stock market is not part of the macroeconomy, it does provide an indication of business and

investor expectations for future economic growth.) What effect will pessimistic business expectations have on the macroeconomy in the present situation?

d) From a Keynesian perspective, what are appropriate macroeconomic policies in the current situation? Explain how these would work.

4. (10 points) Consider the following information on our monetary system:

total bank reserves	\$39.8 billion
required reserves	\$38.3 b.
checkable deposits	\$599.1 b.
currency in circulation (inc. traveler's checks)	\$651.7 b.
small time deposits, savings accounts, and money market funds	\$4,739.2 b.

a) What is the amount of the money supply, M1, in dollars?

b) What is the amount of the money supply, M2, in dollars?

c) Suppose the Federal Reserve wants to decrease interest rates. Should it conduct an open market purchase or sale? Explain.

5. (10 points) A local music store lowered its prices on CDs from an average of \$15 each to \$14 each. It saw its daily CD sales rise from 200 to 225. The store's marginal cost of selling a CD is \$6.

a) Estimate the elasticity of demand for CDs at this store.

b) Did the store's profits rise as a result of the price reduction?

6. (20 points) In a sentence or two, identify the main point of the following authors in their *Classic Readings* articles.

Abba Lerner – “The Economic Steering Wheel: The Story of the People's New Clothes”

Milton Friedman – “Fiscal Policy”

Henry Hazlitt – “ ‘Full Employment’ As the Goal”

John Maynard Keynes – “Magneto Trouble”