

Exam 2 - Principles of Macroeconomics

Prof. Platt - Spring 1997

Please put all answers in your blue book. You have 1 hour and 15 minutes.

1. The U.S. Government recently switched to a chain-weighted index for GDP (and the CPI, for that matter). Why might such a switch be a wise choice?
2. Put an "L" next to each of the following that are leakages and a "I" next to each of the injections.
 - a. M
 - b. S
 - c. I
 - d. NT
 - e. G
 - f. X
3. Let's say that in 1995 the average U.S. income was \$25,000. Of that amount \$20,000 was spent on consumption of domestic goods, \$4,000 on savings, and \$1,000 on consumption of imported goods. In 1996 the average U.S. income was \$27,000. Of that amount \$21,000 was spent on consumption of domestic goods, \$4,600 on savings, and \$1,400 on consumption of imported goods. Given this information, please answer the following questions:
 - a. If the Clinton Administration wants to raise GDP by \$10,000 to close a contractionary gap, how much should they increase government spending?
 - b. If a balanced budget amendment is passed, and the increase in government spending must be paid for with an increase in taxes, how much will they have to increase government spending to close the above mentioned gap?
 - c. How will a change in prices effect the mpc? How will a change in prices effect the Consumption function and the Savings function?
4. Explain the relationship between disposable income and investment, and between interest rates and investment.
5. Which of the following would *not* cause a downward shift in the AE function?
 - a. higher interest rates
 - b. higher prices
 - c. lower disposable income
 - d. lower consumer confidence
6. Explain how unplanned investment (recall that inventory changes are investment) is the mechanism by which we reach a spending equilibrium.

7. If the exchange rate between US dollars and Mexican Pesos falls (ie. Mexican money is more expensive for US folks to buy, and US money is cheaper for Mexican folks to buy), how with effect the AE and the AD Curve? Briefly explain why.
8. True or False and explain: An increase in prices decreases the AE Curve, and thus, decreases the AD Curve.
9. If the mpc gets smaller, ceteris paribus, what would we expect to happen to the AD Curve?
10. How would a decrease in savings change the AD Curve?
11. Which type of unemployment is not present if an economy is producing at potential?
12. With no government interference, we would expect a self-correcting economy to recover from an expansionary gap but prices would be (higher/lower/unchanged) from before.
13. What is “unrealistic” about how a self-correcting economy recovers from a contractionary gap?
14. If there is an increase in overall productivity, ceteris paribus, what happens to the LRAS curve? Assuming price expectations stay the same, how might fiscal policy prevent a contractionary gap?
15. How does fiscal policy prevent inflation in an expansionary period?
16. How does “crowding out” reduce the effectiveness of fiscal policy?
17. There is a contractionary gap when prices are _____ expected.
 - a. higher than
 - b. lower than
 - c. exactly as
 - d. as the Great Yappy (in a most excellent X-Files episode)
18. If people use horses as a medium of exchange, then they
 - a. have a barter economy
 - b. are using commodity money
 - c. are using token money
 - d. are using legal tender
 - e. are using fiat money
19. Explain what Gresham’s law has to say about 2 types of money.