

Final Exam - Principles of Macroeconomics

ECO 202/Spring1997

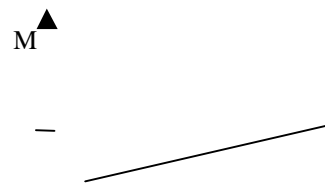
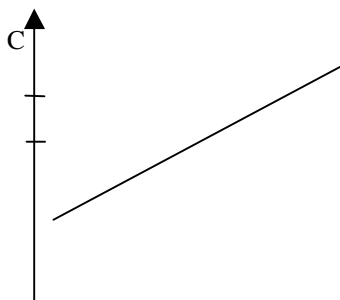
Prof. Platt

Put all answers in your blue book and show all work.

Please read the following portion of an article from this past weekend's *New York Times* and answer questions 1-5.

1. Assume that the population of the United States is 250 million. If the unemployment rate reflects the fact that 6.7 million people were counted as unemployed, what is the labor force participation rate?
2. Consider the prediction that the article makes about the Fed's behavior in the second paragraph.
 - a. Does this imply that the natural rate of unemployment is above or below 4.9%? What other information given in the article backs up this contention? What does this imply about cyclical unemployment?
 - b. If the prediction holds, *exactly* how will the Fed raise interest rates? Explain how the Fed *could* achieve the same goal by using the another method of monetary policy.
 - c. Given your answer to part a), draw the AS/AD diagram for the U.S. economy. Then use a series of graphs to show the entire chain of causation showing how the Fed is expected to behave and the intended effect on the economy.
3. Does the present economy support the Phillips Curve hypothesis? Briefly explain.
4. The recent budget agreed upon by Congress and the Clinton Administration includes some spending cuts as well as tax cuts. Is either of these actions consistent with the necessary fiscal policy, given the state of the economy described in question 2 part a)?
5. There are those who feel that passive policy would be better than active policy over the next few years.
 - a. Given the state of the economy. Explain how passive policy might bring us back to long run equilibrium.
 - b. What is negative by-product of passive policy in this environment?
 - c. On the other hand, why might active policy be a bad idea?
6. If the required reserve ratio is 7% and the Fed has determined that they want to increase the money supply by \$200 million. Should they buy or sell bonds? How much should they buy or sell?
7. Other than control of the money supply, describe 2 other roles of the Federal Reserve System.
8. What is the difference between the Federal Funds Rate and the Discount Rate?
9. Ceteris Paribus, if the mpc is falling, what might we expect to be happening to M2.
 - a. rising
 - b. falling
 - c. staying the same
 - d. it has joined M3 and M4 and produced M8
10. If banks become increasingly concerned that there might be a "run" on the bank and choose to keep excess reserves, what will happen to the money multiplier?
 - a. it will rise

- b. it will fall
 - c. it will stay the same
 - d. it will be inverted
11. Using M1, has V been stable since WWII? What explains this pattern? Does this support backers of the direct channel or the indirect channel?
 12. What is the difference between the long run Phillips curve and the long run AS curve?
 13. Explain how an annually balanced budget will exacerbate business cycles.
 14. Briefly (2 sentences each) explain two arguments for why the deficit is not the problem that we are led to believe that it is.
 15. If the GDP Price Deflator is rising, what *must* be true for real GDP to be rising?
 16. Explain how substitution implies that inflation calculated with the CPI may be higher than the “true” inflation rate.
 17. Some have argued that inflation is necessary to mask real wage decreases needed to recover from recessions. Briefly explain what is meant by this.
 18. If the economy always returns to the LR Supply Curve, how could real GDP be rising over time?
 19. Which of the following is not included in the measurement of GDP? **[There may be more than one correct answer. Circle all correct answers.]**
 - a. Sale of Used Cars
 - b. Sale of Stocks
 - c. Sale of Crack Cocaine
 - d. Services
 20. Define unplanned investment. How does this contribute to the spending equilibrium process?
 21. How will an increase in disposable income change the AD curve?
 - a. it will increase
 - b. it will decrease
 - c. it will not change, you will move along it
 - d. it will get flatter
 22. How does the introduction of the money market (the S & D for cash) mitigate (lessen) the effects of fiscal policy?
 23. Show, in a graph, that if there is an increase in money demand, the Fed can target interest rates, but not the money supply.
 24. If the Fed buys bonds, how will the effect net exports (and hence AD)?
 25. Examine the following graphs. Given the information contained in the graphs, what would be the economy-wide effect of an increase in Government spending of \$100 million?



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100 150 200 DI

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20 30 40 DI

26. **[BONUS QUESTION]** In 3-4 sentences, explain how the Fed's targeting of the Money Supply contributed to the Savings and Loan crisis