Final Exam (Weight 300 Points) STUDENT'S NAME ______________________________

Multiple choice Questions. (Weight 5 points each) Choose the best answer.

1) The unemployment rate is the number of
A) jobless individuals divided by the total labor force.
B) jobless individuals looking for work divided by those employed and unemployed but actively looking.
C) jobless people looking for work divided by the population.
D) people looking for work divided by the population.

2) The value of steel sold to an automobile producer is __________ directly included in the GDP because __________.
A) sometimes; the automobile may not be sold in the current period
B) never; to do so is to double count the value of the steel
C) sometimes; the steel is sometimes not resold in the current period
D) always; it was produced during the current period

3) In the simplest Keynesian model of the determination of income, interest rates are assumed
A) to be endogenous and to influence desired spending.
B) to be endogenous and not to influence desired spending.
C) to be exogenous and to influence desired spending.
D) to be exogenous and not to influence spending.

4) An increase in the money supply will raise equilibrium GDP if the
A) position of the IS curve depends on the level of real money balances.
B) IS curve is negatively sloped.
C) position of the LM curve depends on the level of real money balances.
D) IS curve is not vertical.

5) The aggregate demand curve may be derived from the IS-LM analysis by shifting
A) both the LM and IS curves since the real money supply and real expenditures change when P changes.
B) the real money supply and thus LM curve for each new price level.
C) the IS curve as the price changes.
D) the LM rightward when P increases to define Y.

6) Suppose that members of Congress and the President believe that the natural rate of unemployment is 2% but in fact it is 6%, and employing fiscal policy they increase AD each time unemployment rises above 2%. The underestimation of the natural rate combined with adaptive expectations will
A) lead to a continuous inflation by a shift in only SAS.
B) lead to a continuous inflation by a shift in only AD.
C) lead to continuous increases in output and unemployment.
D) lead to continuous inflation by shifts in both AD and SAS.

7) Unanticipated inflation will hurt __________ and help __________.
A) the government; tax payers B) pensioners; borrowers
C) borrowers; pensioners D) homeowners; banks

8) Once monetary policy is dedicated to controlling the level of nominal GDP, then fiscal policy can be used to
A) control the level of inflation, with a high budget deficit implying a faster rate of inflation.
B) choose the overall level of interest rates, with a high budget deficit implying a high level of interest rates.
C) control the level of inflation, with a high budget surplus implying a faster rate of inflation.
D) choose the overall level of interest rates, with a high budget surplus implying a high level of interest rates.

9) A major side-effect of a stimulative fiscal policy is that it will
A) discriminate in favor of housing.
B) permanently raise the rate of inflation.
C) increase the natural rate of unemployment.
D) crowd out private expenditures.

10) The conditions for joining the "Euro" single-currency block led a number of European countries to __________ and consequently reduce their debt-GDP ratios.
A) tighten fiscal policy B) loosen fiscal policy
C) loosen monetary policy D) tighten monetary policy

11) The national debt must eventually be paid off to
A) no one, as long as there is confidence in the continuing viability of the government's taxing powers.
B) ourselves, which implies we collectively can expect an increase in income in the future.
C) foreigners, which means a loss of freedom in the future.
D) the government, which implies additional revenue to the government in the future.

12) Over a decade or longer, a government budget deficit
A) increases national saving and economic growth.
B) reduces national saving and stimulates economic growth.
C) reduces national saving and economic growth.
D) increases national saving and decreases economic growth.

13) As an individual, you cannot participate in the financial markets to issue new stock or sell new bonds because
A) your good reputation is insufficient to convince savers.
B) your bank has foreclosed on your automobile loan.
C) it is too costly for individual savers to research your credit worthiness.
D) you have a bad reputation.

14) The quantity equation makes the demand for money depend on
A) the unemployment rate and the level of interest rates.
B) interest rates and the unemployment rate.
C) the inflation rate and the unemployment rate.
D) None of these.

15) The quantity theory of money assumed
A) the fraction of income people desire to hold in the form of money is a constant.
B) a rise in money supply causes a proportionate fall in velocity.
C) a fall in the velocity of money causes a proportionate increase in the money supply.
D) that an increase in prices causes a proportionate increases in real GDP.

16) Keynes's "speculative motive" for holding money
A) assumed that as the interest rate rose speculators would move form bonds to money.
B) assumed that as the interest rate fell speculators would move from money to bonds.
C) was based on the behavior of speculators who make gains by switching their asset holdings between bonds and common stocks.
D) assumed that there was some "normal" interest rate to which the market would return.

17) If the level of interest rates increases, then the current value and price of a bond paying a fixed interest payment will
A) fall since new bonds offer higher rates.
B) first rise then fall as bond investors calculate the effects of the change in rates.
C) rise since new bonds offer higher rates.
D) remain unchanged since its underlying value, the interest payment is fixed.

18) The central issue in the stabilization policy debate is
A) the role of money in the inflationary process.
B) the effectiveness of monetary policy and fiscal policy.
C) the location of the sources of economic instability in the economy.
D) the effectiveness of fiscal policy, but not monetary policy.

19) The increase of the real money supply by 10% by the Federal Reserve when the unemployment rate rises by 1% is an example of
A) the conduct of procyclical monetary policy.
B) the conduct of nondiscretionary fiscal policy.
C) the utilization of rigid policy rule.
D) the utilization of feedback policy rule.

20) Non-activists believe that the IS curve is
A) very flat and that real output is not sensitive to monetary policy in the short run.
B) very steep and that real output is sometimes very sensitive to monetary policy in the short run.
C) very steep.
D) very flat and that real output is sometimes very sensitive to monetary policy in the short run.

21) In the early 1970s monetary growth was relatively stable yet unemployment and prices were quite unstable. This suggests that
A) the government was following a monetary rule.
B) government spending must have been destabilizing.
C) policy activism is superior to policy rules.
D) monetary rules will not iron out every short-run fluctuation resulting from shocks.

22) A policymaker would prefer that the lag in the effect of a policy be
A) long and fixed in magnitude or size.
B) short and fixed in magnitude or size.
C) long and variable in magnitude or size.
D) short and variable in magnitude or size.

23) Which of the following statements best describes the rational expectations hypothesis?
A) individuals will not enter into long-term agreements unless they are certain about the payments they will receive
B) it is likely that individuals will consistently make errors
C) it is reasonable to expect individuals to consistently underestimate the level of inflation
D) individuals will make random errors, independent of previous errors

24) Business cycles will occur if either of the two theories below characterizes the behavior of the economy
A) deflation impotence or rigid nominal wages.
B) the classical or the real balance theory.
C) the classical or the Keynesian theories of aggregate demand.
D) A and C.

25) If it is less costly for business firms to adjust the labor demanded as the price level changes than it is for households to adjust Ns, then in the short-run
A) Ns has a positive slope and the demand for labor (Nd) negative slope.
B) Nd has a negative slope and the supply of labor (Ns) a positive slope.
C) SAS has a positive slope.
D) AD has a negative slope.

26) Switzerland has experienced the lowest rate of price increases in the post World War II period. Consequently, Lucas would predict
A) small demand responses to variations in the inflation rate.
B) small supply responses to variations in the inflation rate.
C) large demand responses to variations in the inflation rate.
D) large supply responses to variations in the inflation rate.

27) According to the classical model, real wages should
A) rise during recessions.
B) stay the same during recessions but rise during expansions.
C) fall during recessions.
D) remain constant.

28) The structural deficit is
A) the difference between the actual deficit and the natural employment deficit and it increases whenever income rises.
B) identical to the natural employment deficit and it decreases whenever the natural level of output increases.
C) identical to the natural employment deficit and it increases whenever the natural level of output increases.
D) identical to the natural employment deficit and it decreases whenever tax rates are cut.

29) The natural employment surplus __________ be used to determine the effectiveness of discretionary fiscal policy actions because __________.
A) can; it includes non-discretionary spending changes
B) cannot; it excludes non-discretionary spending changes
C) cannot; it includes non-discretionary spending changes
D) can; it excludes automatic stabilization expenditures

30) The cyclical deficit is
A) the same as the structural deficit.
B) what the budget deficit would be if the economy were operating at the natural real GDP level.
C) the amount by which structural deficit exceeds the actual budget deficit.
D) the amount by which the actual government budget deficit exceeds the structural deficit.

31) The 2001 recession was caused principally by
A) a drop in autonomous consumption spending.
B) a slowing in the growth of the money supply.
C) a drop in real business investment.
D) a decrease in government spending

32) A government budget deficit is financed by a combination of
A) domestic investment rising relative to saving and exports rising relative to imports.
B) saving rising relative to domestic investments and exports rising relative to imports.
C) saving rising relative to domestic investment and imports rising relative to exports.
D) domestic investment rising relative to saving and imports rising relative to exports.

33) The ballooning of the U.S. foreign debt to 500 billion dollars by 1988 implied that
A) the ratio of foreign debt to the U.S. GNP was increasing.
B) a foreign trade deficit is required to reduce the interest payment burden.
C) the ratio of foreign debt to the U.S. GNP was decreasing.
D) a foreign trade surplus is required to reduce the interest payment burden.

34) If the Federal Reserve intervenes in the foreign-exchange markets and buys foreign currencies
A) the U.S. money supply rises and foreign currencies depreciate.
B) the U.S. money supply falls and foreign currencies appreciate.
C) the U.S. money supply rises and foreign currencies appreciate.
D) the U.S. money supply falls and foreign currencies depreciate.

PROBLEM 1 (Weight 40 points)

Derive the LM curve by one of the standard methods shown either in the Gordon *Macroeconomics* text. Be sure to label all axis and curves on your graphs.

Explain in writing to what market your derivation brings equilibrium and how it accomplishes this.

PROBLEM 2 (Weight 40 points)

Derive the IS curve by one of the standard methods shown in either the Gordon *Macroeconomics* text. Be sure to label all axis and curves on your graphs.

Explain in writing to what market your derivation brings equilibrium and how it accomplishes this.

PROBLEM 3 (Weight 50 points)

What are the principal differences between flexible and fixed exchange systems?

EC 301 Final Examination Answer Sheet

Student Name: ____

Multiple Choice Questions (5 Points Each)

1.	13.	25.
2.	14.	26.
3.	15.	27.
4.	16.	28.
5.	17.	29.
6.	18.	30.
7.	19.	31.
8.	20.	32.
9.	21.	33.
10.	22.	34.
11.	23.	
12.	24.	

Problems (130 points possible)

Problem 1 (Weight 40 points).