
Directions:

- i) **Answer #1 and #2. Complete TWO from #3, #4 or #5.** I will grade the first four problems I see.
- ii) Please provide responses that are clear, concise, yet comprehensive! That is, explain everything in exactly the proper amount of detail.
- iii) Relevant, properly labeled, derivations, diagrams or graphical analyses are mandatory whenever appropriate.
- iv) Label each part, (i), (ii). Each question (1, 2, 3, 4) is worth 25 points, for 100 total points.

Part I: You must answer #1 and #2.

1. i) Illustrate and explain how a decrease in the expected price levels shifts aggregate supply to the right.
- ii) . In an article entitled "Strong Chairmen Weaken the Fed" in the Wall Street Journal (week of April 22, 1991), Jerry Jordan states:

"The secrecy about what actually goes on in an Open Market Committee meeting is self-imposed. And the Fed watcher industry thrives on secrecy. Other central banks, such as the German Bundesbank, hold a press conference and announce their policy decisions at the end of their meetings, leaving no room for doubt or speculation about their actions. The Fed contributes to short-term volatility in markets by making the rest of us guess at what they are really up to."

What model of the macroeconomy do you think the author is using? Show and explain why secrecy regarding policy actions leads to output instability.

- 2) i) New Classical macroeconomists argue that an announced, credible policy of expanding the money supply could decrease aggregate output rather than increase it. Using the New Classical model, use the labor market and AS\AD (Y^s \Y^d) to illustrate and explain the reasoning behind this argument.
- ii) Would (a) a Keynesian economist, and (b) a monetarist economist agree with the assumptions and conclusions in (i)? In each case, use the labor market and AS\AD (Y^s \Y^d) to thoroughly explain the differences.

Part 2: Complete TWO (only) from #3, #4 or #5.

*3) i) Show and explain how "labor fooling" in the labor market can lead to variations in the slope of the aggregate supply curve under (a) new classical, (b) keynesian and (c) monetarist assumptions.

ii) Use the Phillips Curve analysis to illustrate and explain how "labor fooling" can lead to variations in output and inflation under (a) new classical, (b) keynesian and (c) monetarist assumptions.

*4) Assume the following information: $C = 300 + .8Y^{dis}$; $I = 200$; $G = 300$; $T = 50$; $EX = 100$; $IM = 20 + 0.1Y^{dis}$.

i) What are the equilibrium values of GDP and savings?

ii) Graph the Keynesian Cross. Label it with Y_E and the current value of autonomous expenditures.

*5) Show how an increase in the money supply affects aggregate demand via IS/LM when:

- i) investment demand is interest inelastic.
- ii) investment demand is interest elastic.

Econ 332, Intermediate Macroeconomics
Sample Final Exam 2
Dr. Raymond

Directions:

- You must answer #1 & #2.
Also complete TWO from #3, #4, #5, or #6.
- If choices are not properly indicated, I will grade the first four problems I see.
- Please provide responses that are clear, concise, yet comprehensive!
- Explain everything in exactly the proper amount of detail. Points may be deducted for extraneous information.¹
- Relevant, properly labeled, derivations, diagrams or graphical analyses are mandatory whenever appropriate.
- Accurately label each question you complete (1,...,6) and each part (i,...,iii).

1. Refer to transitions in the labor market to complete the following questions.

- i. Explain and derive the keynesian aggregate supply curve when information is asymmetric. (8points)
- ii. Explain and derive the new classical aggregate supply curve assuming rational expectations. (8points)
- iii. In which case (i or ii above) is monetary policy most effective (a) in the short-run? (b) in the long-run? Explain. (4+4=8points)

2. i. Describe the basic tenets of monetarism. (8points)

ii. By agreeing to lower the discount and federal funds rates 0.5% last week, the Federal Reserve effectively agreed to increase the money supply. Using the Keynesian IS/LM model, determine the effect will this have on GDP and interest rates charged by private financial institutions.

Describe the effect of this policy under the monetarist assumptions concerning money demand (LM) and investment (IS)? (8points)

iii. Illustrate and explain whether this policy is more effective under monetarist or Keynesian assumptions. (8points)

3. [Note: Some classes do not cover any of this material.]

Assume the country currently faces a Balance of Payments (external) deficit, with an internal balance, flexible (but possibly somewhat slow adjusting) exchange rates, and a high degree of international capital mobility.

- i. List three solutions/policies that could achieve a simultaneous internal and external balance. (18points)
- ii. As a policy maker, which would you advocate? Why? (6points)

¹ Irrelevant, unnecessary, superfluous.

4. Given the complete Keynesian economy:

$$C = 300 + .8Y^{dis}; \quad I = 200 - 20r; \quad G = 300; \quad T = 200; \quad M^s = 1000; \quad \frac{M^d}{P_o} = 400 + y - 20r; \quad P_o = 1.00$$

i. Determine the equations for IS and LM. Then, solve the Keynesian system for the equilibrium interest rate and income. (12points)

ii. Calculate the extent of "crowding out" if government spending increases to 400. (12points)

5. In a Wall Street Journal article entitled "A Bush Economist Is Urging Hands Off," about John Taylor, an economist on the Council of Economic Advisors at the time, the following statement appears:

"At the Fed for instance, the importance of credibility is stressed...hard-liners at the Fed... say the Fed can reduce inflation to zero without a recession. Once the public believes the Fed is serious, it's argued, the public's behavior will change -- inflationary expectations will drop -- and the Fed's job will be easier."

i. Show and explain why credibility is so important for avoiding a recession when contracting the money supply. (24points)

6. Assume the following for the Keynesian Cross:

$$C = 100 + .8Y^{dis}; \quad I = 200; \quad G = 300; \quad T = 100; \quad EX = 100; \quad IM = 0.1Y^{dis}, \quad \text{and } T=0.05C.$$

All values are in billions of \$.

(i) Sketch and label autonomous expenditures on the Keynesian Cross. Calculate the equilibrium values of (ii) income, (iii) consumption, (iv) savings, (v) net taxes, (vi) net exports. (4points each)