

Part I: Multiple Choice. Each is worth 2 points.

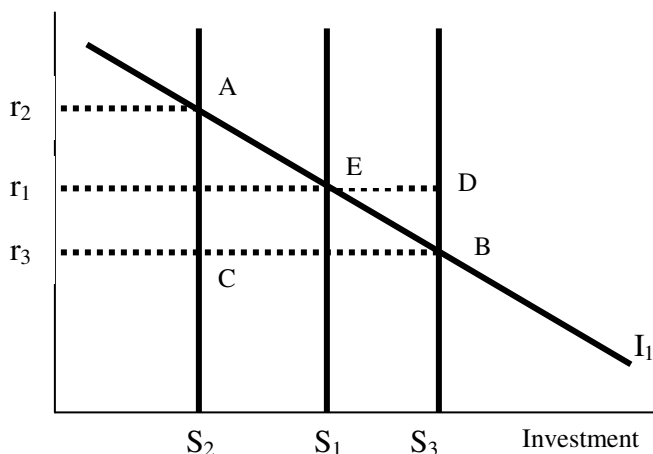
1. Macroeconomists study all of the following issues **except**:
 - a) the determinants of inflation
 - b) the relative markets shares of General Motors and Ford.
 - c) the growth of total production in the United States.
 - d) the amount of imports and exports between the United States and China.

2. The market in which the assumption of continuous market clearing seems to be **least** applicable is:
 - a) the stock market
 - b) the market for wheat
 - c) the labor market
 - d) the market for US Treasury bonds

3. If GDP (measured in billions of current dollars) is \$5,465, consumption is \$3,657, investment is \$741, and government purchases are \$1,098, then net exports are:
 - a) \$131
 - b) - \$131
 - c) \$31
 - d) - \$31

4. According to the neoclassical model of distribution, the supply and demand for goods and services are balanced by changes in:
 - a) government spending
 - b) taxes
 - c) monetary policy
 - d) interest rates

5. Refer to the diagram below. The economy begins in equilibrium at Point E, representing the real interest rate r_1 , at which saving, S_1 , equals desired investment, I_1 . What will be the new equilibrium combination of real interest rate, saving, and investment if the government cuts spending, holding other factors constant?
 - a) Point A
 - b) Point B
 - c) Point C
 - d) Point D



6. To reduce the money supply, the Federal Reserve:
 - a) buys government bonds.
 - b) sells government bonds.
 - c) buys corporate stocks.
 - d) sells corporate stocks.

7. If the nominal money supply rises by 6 percent, the price level rises by 4 percent, and output rises by 3 percent, then, according to the quantity equation, income velocity:
- rises by 13 percent
 - rises by 7 percent
 - rises by 3 percent
 - rises by 1 percent

Part II: Answer any THREE questions. Each is worth 6 points.

8. The average unemployment rate in western Europe is higher than in the United States.
- Explain one difference between the European and U.S. economies that is consistent with more *structural* unemployment in Europe.
 - Explain one difference between the European and U.S. economies that is consistent with more *frictional* unemployment in Europe.
9. During WWII, both Germany and England had plans for a paper weapon: they each printed the other's currency with the intention of dropping large quantities by airplane. Why might this have been an effective weapon? Use the quantity theory in your explanation. Make sure you write down the quantity theory equation and define all terms.
10. There are a number of statistics computed to measure the price level, such as the GDP deflator and the CPI. The choice of which of these measures to use depends in many cases on the specific question in which you are interested. For each of the following situations, state whether the CPI or GDP deflator is a more appropriate measure to use and explain why the statistic is preferred.
- You are interested in looking at the impact of higher prices of imported oil in the overall cost of living.
 - The government is interested in whether increases in defense spending are affecting the price level.
 - An economic consulting firm is investigating the impact on the aggregate price level of more computers and electronic technology used in production.
11. Consider two competitive economies that have the same quantities of labor ($L = 400$) and capital ($K = 400$), and the same technology ($A = 100$). The economies of the countries are described by the following Cobb-Douglas production functions:
- North Economy: $Y = AL^3K^7$
 South Economy: $Y = AL^7K^3$
- Which economy has the larger total production? Explain.
 - In which economy is the real wage larger? Explain.
 - In which economy is labor's share of income larger? Explain.

Part III: Answer each question.

12. Suppose that GDP (Y) is 9,000. Consumption (C) is given by the equation $C = 900 + 0.75(Y-T)$. Investment (I) is given by the equation $I = 2600 - 200r$ where r is the real interest rate in percent. Taxes (T) are 800, and government spending (G) is 900.
- What are the equilibrium values of C , I , and r ? Illustrate the determination of the equilibrium interest rate with a diagram of the loanable funds market. [4 pts]
 - What are the values of private saving, public saving, and national saving? [2 pts]
 - Congressional Democrats have proposed to raise taxes in order to reduce the budget deficit. What would happen to the equilibrium values of C , I , and r , if the Democrats are successful in raising taxes to $T = 900$? Illustrate the impact of the tax increase on your diagram from part (c). [4 pts]
 - What are the new values of private saving, public saving, and national saving? [2 pts]