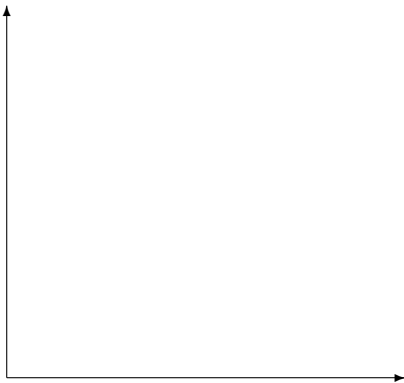


ECON 312 - Exam # 1**Name:****1 True, False or Uncertain**

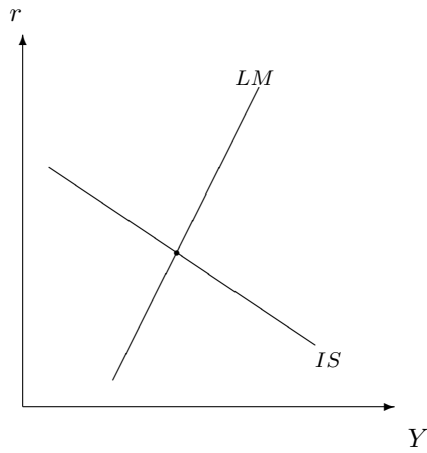
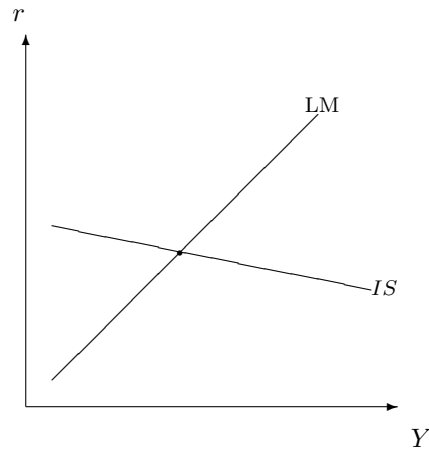
Answer each of the following questions either true, false, or uncertain and explain your answer. Because the *explanation* is the most important part of your answer, you *must* provide an explanation for each question to receive full credit. This section should take you no longer than 30 minutes to complete.

1. Expansionary monetary policy increases interest rates. (*5 points*)



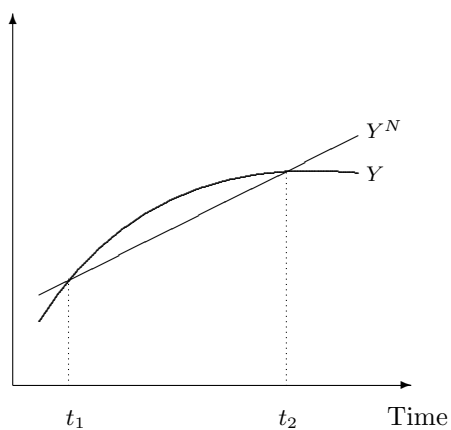
2. *None* of the following transactions are included in GDP: (a) Mr. X cashes his weekly paycheck; (b) Mr. X buys a loaf of bread; (c) Mr. X gives his neighbor some tomatoes from his garden; (d) Mr. X washes his neighbor's car for \$20. (*5 points*)

3. The difference between *Economy 1* and *Economy 2* is that I_p and C_a are more sensitive to changes in interest rates in *Economy 2* than in *Economy 1*. (5 points)

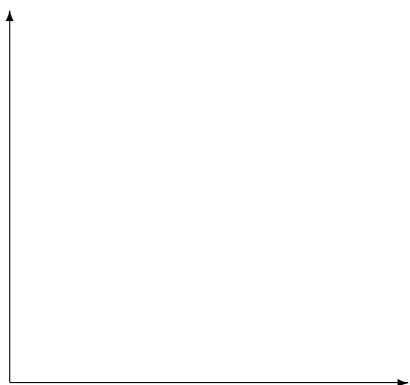
Economy 1Economy 2

4. Ms. Smith has just graduated from college with an economics degree. After spending four years as a full-time student, she graduated at the end of August and began searching for a job on 1 September. On 15 September, she found a job at an economic consulting firm and started work the same day. Based only on Ms. Smith's recent activities, the labor force was the same size on September 1 as it was on August 31, but the labor force increased by one on September 15th. (5 points)

5. Based on the time path of natural real GDP (Y^N) and actual real GDP (Y) in this economy, both the inflation rate and the unemployment rates were rising from time t_1 until time t_2 . (5 points)



6. A tax cut reduces both real GDP and interest rates. (5 points)



2 Analysis

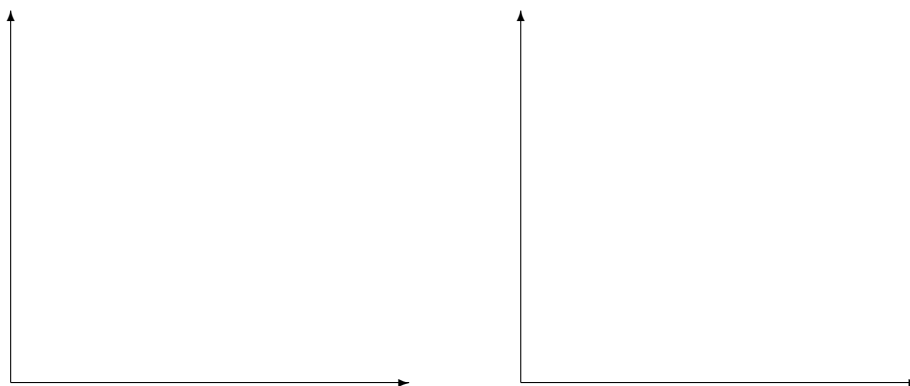
Answer the following questions in the space provided. Question 7 should take you no more than 30 minutes to complete. Question 8 should take you no more than 15 minutes to complete.

7. This question compares two economies, *Economy A* and *Economy B*, in the context of macroeconomic models. Where appropriate, draw graphs on the following axes depicting each economy.

- 7.a Suppose that interest rates in Economy A are higher than interest rates in Economy B ($r_A > r_B$) and real GDP is larger in Economy B than in Economy A ($Y_B > Y_A$). Show how real GDP and interest rates are determined in each economy. Label the equilibrium values of real GDP and interest rates in each economy (Y_A, r_A) and (Y_B, r_B). (10 points)

Country A

Country B



- 7.b Suppose that you model the determination of Government Tax Revenues (T) differently in each economy. The tax function for each economy is shown below.

Country A

Country B

$$T_A = T \quad T_B = T_b - tY$$

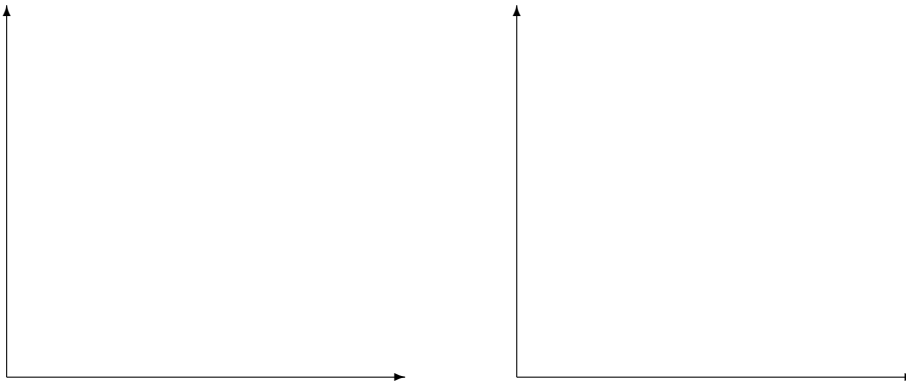
Are tax revenues exogenous in *Country A*? In *Country B*? Explain. Which country has a larger government spending multiplier? (15 points)

- 7.c Suppose that economic policy makers in both economies want to increase real GDP. In terms of the parameters of the IS/LM model, assume that the two economies are identical except that transactions demand for money is very weak in Economy A and very strong in Economy B. In other words, money demand in Economy A does not respond very much to changes in real GDP, but money demand responds strongly to changes in real GDP in Economy B.

How does this difference in money demand effect the IS/LM model? How does it affect the choice of policies used to increase real GDP in each economy? Use graphs to demonstrate your answer. (20 points)

Country A

Country B



- 7.d Suppose that the expectations of businesses in *Country A* shift toward more optimism about the future. Show the effect of this change on current interest rates and real GDP of this change relative to the initial equilibrium levels of these variables. (10 points)

Country A



8. According to the National Bureau of Economic research (NBER), the U. S. economy has been in a recession since March 2001. The Bush administration's first major economic policy initiative was a large income tax cut that took place in 2001. Since 2001, the actual Federal government budget deficit has increased substantially. Define the following budget-related terms:

8.a *Actual budget deficit (2 points)*

8.b *Cyclical budget deficit (2 points)*

8.c *Structural budget deficit (2 points)*

Describe how each of the following changed in response to the recession that began in March 2001 and in response to the tax cut by circling the appropriate response.

8.d *Actual budget deficit (2 points)*

Recession:	Increased	Decreased	No Change
Tax Cut:	Increased	Decreased	No Change

8.e *Cyclical budget deficit (2 points)*

Recession:	Increased	Decreased	No Change
Tax Cut:	Increased	Decreased	No Change

8.f *Structural budget deficit (2 points)*

Recession:	Increased	Decreased	No Change
Tax Cut:	Increased	Decreased	No Change

8.g Explain how natural real GDP is related to each of these three budget concepts. (3 points)

Actual budget deficit:

Cyclical budget deficit:

Structural budget deficit: