Test 2
Econ322 Section 002
Chappell
April 6, 2009

Name _____

Last 5 Digits _____

Instructions

Fill in your name and last five digits of your student number on this test sheet.

Multiple Choice questions must be answered on the test form. Please fill in your last name and your first name in the spaces provided. Then bubble in the appropriate letters below your name.

You must also fill in the last 5 digits of your student number in the field called "ID Number." Use the 5 columns on the left when you fill in these digits. Then bubble in the appropriate spaces below your number.

Problems and Analytical Questions should be answered directly on the test sheet. You must show your work. If you do not show your work, you may not get full credit even if your numerical answer is correct.

Multiple Choice Questions are worth 3 points each.

Analytical Questions are worth 13 points each.

This implies that 104 points are available, however grades will be truncated so that 100 is the maximum possible score.

Exam

Name_____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) Why do people keep currency in their pockets when bank deposits pay interest? 1) _____

A) Because bank deposits lose value due to inflation.

B) Because currency is more liquid.

C) Because banks might steal your money.

D) Because bank deposits lose value due to changes in interest rates.

2) The opportunity cost of holding currency decreases when 2) _____

A) the interest rate on money decreases.

B) wealth decreases.

C) income decreases.

D) the interest rate on bonds decreases.

3) An increase in expected inflation is likely to cause 3) _____

A) an increase in the demand for real balances.

B) a decline in the demand for real balances.

C) no change in the demand for real balances only if the income elasticity of real money demand is zero.

D) no change in the demand for real balances.

4) If there is a financial panic and increased uncertainty about the returns in the stock market and bond market, what is the likely effect on money demand? 4) _____

A) Money demand rises.

B) Money demand declines first, then rises when inflation increases.

C) The overall effect is ambiguous.

D) Money demand declines.

5) Velocity is defined as 5) _____

A) mc^2.

B) nominal money stock/nominal GDP.

C) real money stock/real GDP.

D) nominal GDP/nominal money stock.

6) If the nominal money supply doubles while real money demand is unchanged, what happens to the price level? 6) _____

A) The price level is unchanged.

B) The price level falls by one-half.

C) The price level increases by a factor of four.

D) The price level doubles.

7) An adverse supply shock would cause the *FE* line to 7) _____

A) remain unchanged if the shock is temporary; shift to the right if the shock is permanent.

B) shift to the right.

C) remain unchanged.

D) shift to the left.

8) An increase in labor supply would cause the *IS* curve to 8) _____

A) shift down and to the left.

B) shift up and to the right only if people face borrowing constraints.

C) remain unchanged.

D) shift up and to the right.

9) A decrease in wealth would cause the *IS* curve to 9) _____

A) shift up and to the right.

B) shift down and to the left.

C) shift up and to the right only if people face borrowing constraints.

D) remain unchanged.

10) A rise in the price of a bond causes the yield of the bond to 10) _____

A) fall.

B) rise if it's a short-term bond and fall if it's a long-term bond.

C) rise.

D) remain unchanged.

11) You have just read that the Federal Reserve has increased the money supply to avoid a recession. For a given price level, you would expect the *LM* curve to 11) _____

A) shift up and to the left as the real money supply falls.

B) shift down and to the right as the real money supply rises.

C) shift down and to the right as the real money supply falls.

D) shift up and to the left as the real money supply rises.

12) Suppose the intersection of the *IS* and *LM* curves is to the right of the *FE* line. What would most likely eliminate a disequilibrium among the asset, labor, and goods markets? 12) _____

A) A rise in the price level, shifting the *IS* curve up and to the right

B) A fall in the price level, shifting the *LM* curve down and to the right

C) A fall in the price level, shifting the *IS* curve down and to the left

D) A rise in the price level, shifting the *LM* curve up and to the left

13) Keynesian economists believe that in the short run, 13) _____

A) money neutrality exists and prices do not adjust rapidly.

B) money neutrality does not exist and prices adjust rapidly.

C) money neutrality exists and prices adjust rapidly.

D) money neutrality does not exist and prices do not adjust rapidly.

14) Which of the following changes shifts the *AD* curve down and to the left? 14) _____

A) A decrease in corporate taxes

B) A rise in the nominal money supply

C) A decrease in consumer confidence

D) A temporary increase in government purchases

15) The long-run aggregate supply curve 15) _____

A) is horizontal.

B) is vertical.

C) slopes upward.

D) slopes downward.

16) Labor hoarding occurs when 16) _____

A) because of hiring and firing costs, firms retain workers in a recession that they would otherwise lay off.

B) firms keep good workers so other firms can't hire them.

C) involuntary unemployment exceeds voluntary unemployment.

D) the unemployment rate exceeds the natural rate of unemployment.

17) A temporary increase in government purchases in the classical model would 17) _____

A) shift the labor demand curve to the right.

B) shift the production function to the right.

C) shift the marginal product of labor curve to the left.

D) shift the labor supply curve to the right.

18) Reverse causation could explain the observed correlation between money growth and real output growthe if 18) _____

A) expected future increases in the money supply cause increases in current output.

B) expected future increases in output cause increases in the current money supply.

C) current increases in output cause future increases in the money supply.

D) current increases in the money supply cause future increases in output.

19) If producers have imperfect information about the general price level and sometimes misinterpret changes in the general price level as changes in relative prices, then 19) _____

A) the short-run aggregate supply curve is vertical.

B) the aggregate demand curve is vertical.

C) the aggregate demand curve is horizontal.

D) the short-run aggregate supply curve slopes upward.

20) According to the misperceptions theory, when the price level falls below the expected price level 20) _____

A) the economy moves along its *SRAS* curve. B) the economy moves along its *LRAS* curve.

C) the economy moves along its *AD* curve. D) the economy's *SRAS* curve shifts up.

21) According to the efficiency wage model, firms will pay the real wage that 21) _____

A) maximizes the marginal productivity of capital and the marginal productivity of labor together.

B) maximizes effort per dollar of real wage.

C) maximizes workers' marginal productivity.

D) minimizes hiring and training costs to the firm.

22) In the Keynesian model with efficiency wages, 22) _____

A) an increase in labor supply increases employment.

B) the full-employment line is determined where the quantity of labor demanded equals the quantity of labor supplied.

C) a decrease in labor supply shifts the *FE* line to the left.

D) the full-employment level is determined at the intersection of the labor demand curve and the efficiency wage line.

23) When the demand for an imperfect (monopolistic) competitor's product is greater than it planned, and when menu costs exist, the firm will probably 23) _____

A) increase the price of the product until supply equals demand.

B) allow a shortage of the product to develop, without changing the product's price.

C) reduce the price until supply equals demand.

D) meet the demand at its set price.

24) In the Keynesian model, short-run equilibrium occurs 24) _____

A) where the *IS* curve intersects the *FE* line.

B) where the *IS* curve, *LM* curve, and *FE* lines intersect.

C) where the *LM* curve intersects the *FE* line.

D) where the *IS* and *LM* curves intersect.

25) In the Keynesian model, money is 25) _____

A) neutral in the long run, but not in the short run.

B) neutral in neither the short run nor the long run.

C) neutral in both the short run and the long run.

D) neutral in the short run, but not in the long run.

26) Suppose the government decided to ease monetary policy and then increase taxes. In the short run in the Keynesian model, the effect of these policies would be to _____ the real interest rate and _____ the level of output. 26) _____

A) lower; increase

B) lower; decrease

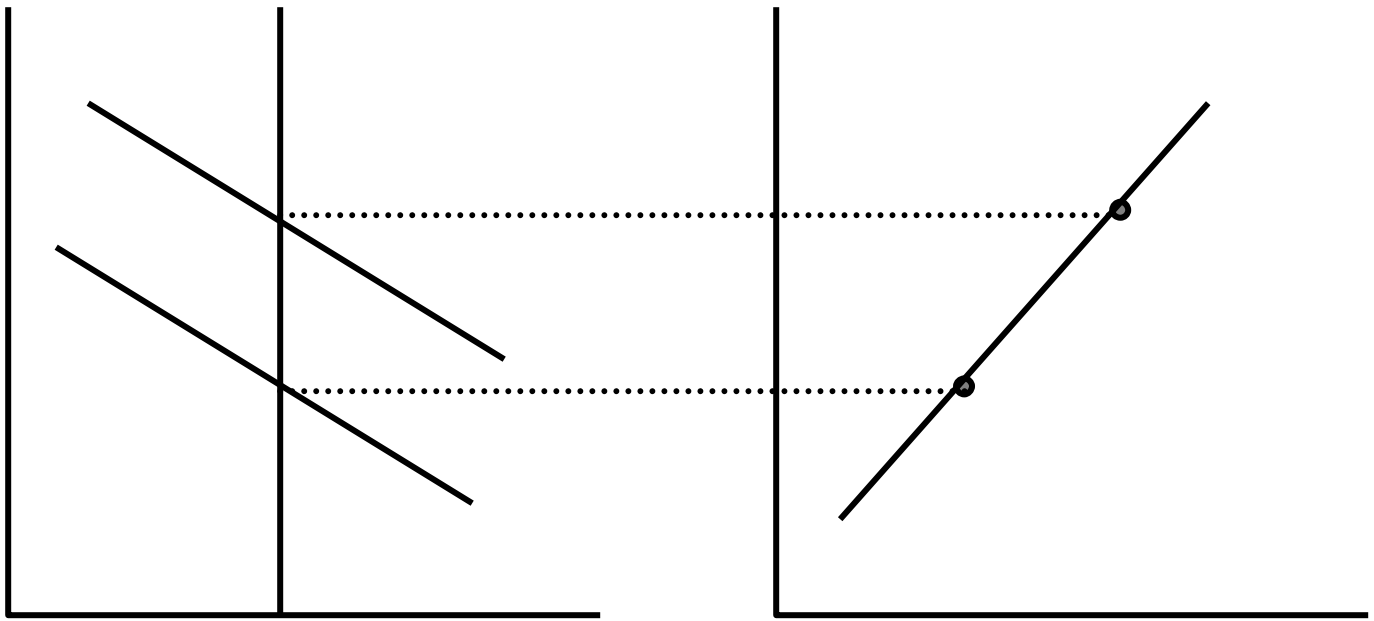
C) have an ambiguous effect on; increase

D) lower; have an ambiguous effect on

Analytical Problem 1

Use the diagram on the next page to illustrate the derivation of the LM Curve. Carefully label all curves and axes so that the diagram shows the derivation of LM.

Then show how an increase in the money supply causes a shift of the LM curve. That is, show change in the money supply in your diagram, and then derive a new LM curve for that changed level of the money supply. Again, carefully label all curves.



Analytical Problem 2

The diagram on the next page illustrates an economy in general equilibrium in the long run. The top panel shows IS, LM, and FE; the lower panel shows AD, SRAS, and LRAS. Clearly label all curves and axes.

Now suppose that government spending is increased. First show what happens in the short-run according to the Keynesian model; then show what happens in the long run.

Be sure to show and label all curve shifts (if a curve shifts, indicate why), and indicate directions of movement in the key variables illustrated in your diagrams.