Economics 104 — Spring 2008
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Final Review Questions

All these questions pertain to the economy in the short run and the microeconomic foundations of macroeconomics. The final exam will cover the entire course.

1. Assume that the economy begins in long-run equilibrium. Explain what happens to output and prices in the short run and the long run when:
a. the Federal Reserve reduces the money supply.
b. the general public chooses to hold a larger fraction of their income in cash balances.
c. the velocity of money rises.

2. If the Fed increases money supply by 5% and the quantity theory of money is true
a. what happens to the AD curve?
b. what happens to output and prices in the short run and the long run?
c. what happens to the real interest rate in the short run and the long run?

3. Explain why the IS curve has a negative slope in (i,Y) space.
Explain why the LM curve has a positive slope in (i,Y) space.

4. An increase in government spending has a larger impact on output in the Keynesian cross model than in the IS-LM model, and a larger impact in the IS-LM model than in the AS-AD model. Explain why.

5. An increase in money supply has no effect on output in each of the following three cases. Explain why.
a. vertical IS curve
b. vertical AS curve
c. fixed exchange rates

6. Within the IS-LM framework, explain the impact on income and interest rates of the following:
a. an increase in the demand for money
b. an increase in investment demand
c. an increase in consumer savings

7. The AS curve is steeper in countries in which there is a great deal of variability in prices. How does the imperfect-information model explain this?

8. Make the case for passive policy rather than active policy.
Make the case for policy conducted by rules rather than by discretion.

9. Consider a small open economy with flexible exchange rates. Explain the impact of the following on Y, i, and e.
a. a decrease in taxes
b. an increase in money demand
c. the imposition of import quotas

10. Now consider a large open economy with flexible exchange rates. How would your answers to 9 above be modified?

11. Three stylized facts about the macroeconomy are that a) real wages are slightly procylcical, b) productivity is procylccical and c) changes in output are very persistent or long-lasting. Provide two different explanations for each of these stylized facts.

12. In an IS-LM model with flexible prices and output always at its natural rate, what does the LM curve determine? Why can the LM curve be ignored for the purposes of understanding real variables?

13. What caused the Great Depression? How might a Keynesian answer this question? How might a monetarist? How might a real business cycle person?

14. Why is the short run MPC smaller than the long-run MPC? What would Franco Modigliani say? What would Milton Friedman say?

15. Under what conditions would consumption follow a random walk? Explain.

16. What is Ricardian Equivalence? Under what conditions might it fail?

17. Why might the stock market be closely tied to fluctuations in output and employment according to James Tobin?

18. If most shocks to the economy are IS shocks, should the Federal Reserve target money supply or the interest rate in order to stabilize the economy? Explain.

19. Even though the monetary base rose between August 1929 and March 1933, the money supply fell 28%. Why might you expect this given the numerous runs on banks resulting from frequent bank failures?

20. Why does the efficient market hypothesis suggest that stock prices should follow a random walk?