

Homework 2

Spring 2009 ECO 410
Macroeconomic Theory

Professor Li Gan
Due 02/19/2009, in class

(A) Multiple Choice Questions: (3 points per multiple choice problem) 25 questions

1. The quantity theory of money assumes that:
 - A) income is constant.
 - B) velocity is constant.
 - C) prices are constant.
 - D) the money supply is constant.

2. The current hyper-inflation in Zimbabwe is caused by:
 - A) corruption of the government officials.
 - B) its central bank keep printing money.
 - C) the Bush foreign policy.
 - D) the current democratic election in Zimbabwe was not a fair election.

3. The Fisher equation is derived based on:
 - A) one cannot make systematic profits in two alternative investment options.
 - B) it is more profitable to invest than to save in a bank.
 - C) nominal interest rate is the sum of real interest rate and inflation.
 - D) people can make precise prediction on the rate of inflation.

4. The hyperinflation experienced by interwar Germany illustrates how fiscal policy can be connected to monetary policy when government expenditures are financed by:
 - A) new taxes.
 - B) borrowing in the open market.
 - C) printing large quantities of money.
 - D) selling gold.

5. A higher government spending may increase the interest rate so that:
 - A) money supply in the economy will be higher.
 - B) the unemployment rate in the economy will be lower.
 - C) total output will be higher .
 - D) private investment in the economy will be lower.

6. To increase the money supply, the Federal Reserve:
 - A) buys government bonds.
 - B) sells government bonds.
 - C) buys corporate stocks.
 - D) sells corporate stocks.

7. The real return on holding money is:
- A) the real interest rate.
 - B) minus the real interest rate.
 - C) the inflation rate.
 - D) minus the inflation rate.
8. A positive relationship between real interest rates and government debt is most obvious in (see Chapter 3)
- A) US in 200-2007.
 - B) About 1730- 1800 in UK.
 - C) Interwar Germany 1922-1924.
 - D) US in 2008.
9. If the transactions velocity of money remains constant while the quantity of money doubles, the:
- A) price of the average transaction must double.
 - B) number of transactions must remain constant.
 - C) price of the average transaction multiplied by the number of transactions must remain constant.
 - D) price of the average transaction multiplied by the number of transactions must double.
10. If the real return on government bonds is 3 percent and the expected rate of inflation is 4 percent, then the cost of holding money is _____ percent.
- A) 1
 - B) 3
 - C) 4
 - D) 7
11. If inflation is 6 percent and a worker receives a 4 percent wage increase, then the worker's real wage:
- A) increased 4 percent.
 - B) increased 2 percent.
 - C) decreased 2 percent.
 - D) decreased 6 percent.
12. If there are 100 transactions in a year and the average value of each transaction is \$10, then if there is \$200 of money in the economy, transactions velocity is _____ times per year.
- A) 0.2
 - B) 2
 - C) 5
 - D) 10
13. Frictional unemployment *cannot* explain the following facts *except*:
- A) why Europe has a higher unemployment rate than the US.
 - B) why some industries pay more than other industries.
 - C) why unemployment benefits increase unemployment rate.
 - D) why blacks have higher unemployment rate than whites.

14. If the fraction of employed workers who lose their jobs each month (the rate of job separation) is 0.01 and the fraction of the unemployed who find a job each month is 0.09 (the rate of job findings), then the natural rate of unemployment is:
- A) 1 percent.
 - B) 9 percent.
 - C) 10 percent.
 - D) about 11 percent.
15. One reason for unemployment is that:
- A) it takes time to match workers and jobs.
 - B) all jobs are identical.
 - C) the labor market is always in equilibrium.
 - D) a laid-off worker can immediately find a new job at the market wage.
16. Any policy aimed at lowering the natural rate of unemployment must either _____ the rate of job separation or _____ the rate of job finding.
- A) reduce; reduce
 - B) increase; increase
 - C) reduce; increase
 - D) increase; reduce
17. *All of the following are reasons for frictional unemployment except:*
- A) workers have different preferences and abilities.
 - B) The minimum wage law.
 - C) the flow of information is imperfect.
 - D) geographic mobility takes time.
18. The demographic explanation for the changes in the U.S. natural rate of unemployment over the past 50 years rests on the idea that:
- A) younger workers have higher rates of unemployment.
 - B) younger workers have lower rates of unemployment.
 - C) baby-boom workers were more productive than other workers because they had greater access to technology.
 - D) baby-boom workers had higher than usual rates of job finding.
19. A tax-cut may increase total tax revenue because:
- A) people consume more goods.
 - B) people now have more money to invest.
 - C) people work more since their after-tax wages are higher.
 - D) people work less because their after-tax income has increased.
20. *All of the following are causes of structural unemployment except:*
- A) minimum-wage laws.
 - B) the monopoly power of unions.
 - C) unemployment insurance.
 - D) efficiency wages.

21. When Henry Ford paid his workers \$5 per day when the prevailing wage was between \$2 and \$3 a day:
- it greatly increased his company's costs.
 - workers reduced their work efforts because they felt they had it made.
 - Ford proved the efficiency-wage theory was wrong.
 - it raised the efficiency of his workers.
22. Entry into and exit from the labor force are important to the determination of the unemployment rate because:
- more than one-half of the unemployed have only recently entered the labor force.
 - most of the unemployed are young workers still looking for their first job.
 - discouraged workers are counted as part of the labor force.
 - almost one-half of all spells of unemployment end in the unemployed person's withdrawal from the labor market.
23. According to Shapiro and Stiglitz's shirking model, a firm pays higher wages in order to:
- make their employees be loyal to the firm.
 - reduce the probability that a worker quits from the firm.
 - increase employees' cost if they are found out not working hard.
 - attract more workers to apply for jobs.
24. When the real wage is above the level that equilibrates supply and demand:
- the quantity of labor supplied exceeds the quantity demanded.
 - the quantity of labor demanded exceeds the quantity supplied.
 - there is no unemployment.
 - the labor market clears.
25. Unions contribute to structural unemployment when collective bargaining results in wages:
- Above the equilibrium level.
 - Below the minimum wage.
 - Below the equilibrium level.
 - Above the level of unemployment compensation.

(B) Essay Questions

- (15 points) Mankiw textbook, pages 186, #5
- (10 points) Consider the current financial crisis. Because of the banks have a large amount of bad loans, they are unwilling to loan people more money.
 - Consider the quantity theory of money: $MV = PY$. What factors are likely to have changed because of lower amount of transactions between banks and people?
 - Using the Fisher equation $i = r + \pi^e$. What would happen?
 - What has the fed done in response in 2008?