**Econ 1120 – INTRO MACRO – Fall-2012 –October 4, 2012**

**REGULAR-UP PRELIM #1 (Thursday)**

**PRINT YOUR NAME: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Your C.U. Netid: \_\_\_\_\_\_\_\_\_\_\_\_\_**

**YOUR C.U. STUDENT NUMBER:** \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Check YOUR TA’s NAME**:   
  
\_\_\_\_\_\_\_\_\_\_\_\_\_TA = Naoko Iida (Tuesday sections)   
  
\_\_\_\_\_\_\_\_\_\_\_\_\_TA = Yuzheng Sun (Wednesday sections)  
  
\_\_\_\_\_\_\_\_\_\_\_\_\_TA = Aichatou Fall (Thursday sections)  
  
\_\_\_\_\_\_\_\_\_\_\_\_\_TA = Yijun Pan (Friday sections)

**INSTRUCTIONS:**

**There are two sections in this exam**

* Part I: 15 multiple choice questions @ 3 points each
* Part II: 3 short answer question (22 points) + 2 Newspaper Article questions (33 points)
* **ANSWER ALL QUESTIONS. TOTAL POINTS = 100. TOTAL TIME = 90 minutes.**
* **Prelim1 score weights 25% of final grade.**
* Please number each exam book from 1 to 6 and write your ID, name and section TA on the front page of each book.

***AGAIN, please….***

**PRINT YOUR NAME: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Your C.U. Netid: \_\_\_\_\_\_\_\_\_\_\_\_\_**

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**GRADING**----------------------------------------------------------------------------------------------------------

**\_\_\_\_\_\_\_\_/45 (mc)\_\_\_\_\_\_/15(short essay 1) \_\_\_\_\_\_/12(short essay 2)**

**\_\_\_\_\_\_\_\_\_/16(long essay 1)\_\_\_\_\_\_\_\_/12(long essay 2)**

**TOTAL: \_\_\_\_\_\_\_\_\_\_\_/100   
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**Part I: Multiple Choice.**

1. Suppose the supply of bananas is inelastic. What can we conclude?
2. A large increase in the demand for bananas will result in a tiny change in the price.
3. A large increase in the demand for bananas will result in a small change in quantity supplied.
4. The slope of the supply curve for bananas is very flat..
5. The slope of the supply curve for coffee is close to 1.
6. A small percentage change in the price leads to large percentage change in quantity demanded.
7. None of the above
8. Which one of the following would be most likely to cause the demand for A to shift to the right?
9. a decrease in the price of A.
10. a decrease in the price of a substitute good.
11. a decrease in the price of a complementary good.
12. a decrease in the price of inputs used to produce A.
13. all of the above will not cause an increase in demand for A.
14. What is not true about the Production Possibility Frontier?
15. It represents the maximum amount of goods and services that can be produced with a given quantity of resources and technology.
16. When the technology for producing goods improves, the frontier moves outwards.
17. When a country has poor management practices, the frontier moves inwards.
18. Production possibility frontier being a straight line implies constant returns to scale.
19. None of the above
20. The country of Eldorado is producing at a full employment level of production. That means that
21. The unemployment rate is 0%
22. There is some structural unemployment
23. There is a maximum participation rate
24. There is cyclical unemployment
25. None of the above
26. Which of the following statements is FALSE?
    1. One problem with any fixed-bundle index as a measure of the cost of living is that it does not account for substitutions that consumers might make in response to price changes
    2. The producer price index is considered to be a leading indicator of future inflation rates
    3. The most accurate overall indicator of inflationary pressures in the economy is the GDP deflator
    4. If inflation happens, the consumer price index somewhat understates changes in the cost of living
27. A consumer’s saving increased from $110 to $150 when his income increased from $750 to $910. This consumer’s
    1. MPS is 40
    2. MPC is 0.75 and the multiplier is 5
    3. MPS is 0.25 and the tax multiplier is -3
    4. MPS is 0.2 and the balanced-budget multiplier is 1
28. For national accounting purposes, which of the following is an investment?
    1. Purchase of 150 shares of Apple stock
    2. Accumulation of inventories on a grocery shelf
    3. Construction of a on campus housing scheme
    4. Both b and c
29. A Canadian company produces and sells carpets in the United States. The profits of this foreign-owned company are included in
    1. U.S. GDP and U.S. GNP
    2. U.S. GDP but not U.S. GNP
    3. U.S. GNP but not in U.S. GDP
    4. Neither U.S. GDP nor U.S. GNP
30. Nominal GDP is **LOWER** this year than last. We can conclude that
    1. Production levels are lower this year
    2. Price levels are lower this year
    3. There is more unemployment this year
    4. We don’t have enough information to conclude that any of a, b or c are true
    5. All of a, b and c are true
31. When aggregate output(income) is to the left of the equilibrium level of GDP

a) Y>(Planned) AE and there will be an unplanned rise in inventories

b) Y<(Planned) AE and there will be an unplanned fall in inventories

c) Y>(Planned) AE and there will be an unplanned fall in inventories

d) Y<(Planned) AE and there will be an unplanned rise in inventories

1. Suppose you bring $100 bills to a bank and deposit them into your savings account. This transaction will
2. increase M1.
3. decrease M1 and increase M2.
4. increase both M1 and M2.
5. decrease M1 but cause no changes to M2.

|  |  |
| --- | --- |
| Big Red Bank | |
| Assets | Liabilities and Net Worth |
| Reserves = 400 | Deposit = 2000 |
| Loans = 2100 | Net Worth = |

1. Refer to the table above for Big Red Bank. Big Red Bank is just meeting its reserve requirement and has no excess reserves. What is the required reserve ratio?
2. 16%
3. 20%
4. 25%
5. None of the above.
6. Following the previous question, what is the net worth of Big Red Bank?
7. 0.
8. 100.
9. 500.
10. 2000.
11. For an economy to produce an output combination beyond its current PPF, the economy must
12. increase its labor force
13. produce more of one good and less of another.
14. waste less resources.
15. reduce its inputs.
16. increase the productivity of its labor force
17. I or V
18. II or III
19. I or II
20. II or IV
21. I only
22. None of the above
23. Who are not included in the number of unemployed people in the US?
    1. a housewife who stays home to take care of her children
    2. your neighbor, a junkie who gave up looking for a job long time ago
    3. a full-time student a Cornell
    4. a recent college graduate from Cornell who has subscribed in the local job agency
    5. A prison grounded in State Prison
    6. a, b and c
    7. a, b, c and e
    8. a and c

**Part II: Short Essays (27 points)**

**1. Unemployment (15 points)**

**“The Structural Obsession”** By Paul Krugman, June 8, 2012

The urge to declare our unemployment problem “structural” — a supply-side problem of some kind, not solvable by the “simplistic Keynesian” notion of just increasing demand — has been quite something to behold. It’s rapidly entering the category of a zombie idea, which just keeps shambling forward no matter how many times it has been killed.

**Basically, structural stories come in two variants: geography and skills. The geography story says that workers are in the wrong places; the skill story that they lack the right knowhow.**

At this point both stories have been thoroughly debunked. Unemployment is [high almost everywhere](http://krugman.blogs.nytimes.com/2012/05/22/sensible-nonsense/).

And via [Mark Thoma](http://economistsview.typepad.com/), the very cautious Dave Altig [looks at recent studies](http://macroblog.typepad.com/macroblog/2012/06/the-skills-gap-still-trying-to-separate-myth-from-fact.html)and concludes that

we’ve been pretty sympathetic to structural explanations for the slow pace of the recovery. Nonetheless, we have yet to find much evidence that problems with skill-mismatch are more important postrecession than they were prerecession. We’ll keep looking, but—as our colleagues at the Chicago Fed conclude in their most recent Chicago Fed Letter—so far the facts just don’t support skill gaps as the major source of our current labor market woes.

Am I totally certain that the problem isn’t structural? Hey, I’m not totally certain of anything! But there really is no evidence, none at all, for a story that nonetheless gets asserted as absolute fact in op-ed after op-ed.

And just think about the fact that this completely unsupported claim about structural unemployment is being used as an argument against doing anything to help millions of unemployed workers find jobs.

1. Please briefly explain structural unemployment and cyclical unemployment. (4 points)
2. From the perspective of government, please address the specific policies which are able to solve structural and cyclical unemployment. (6 points)
3. In addition to the types of unemployment mentioned above, please list at least 1 other type of unemployment and give a brief explanation. (5 points)
4. The structure unemployment is the unemployment due to the change of industry structure, such that the works do not have enough knowledge and profession which industries/companies require. Cyclical unemployment happens because of recession or depression.
5. For structure unemployment, government can provide funding to encourage universities to set up related program teaching the unemployed required skill for new developing industries. As for the cyclical unemployment, because it is due to aggregated demand and supply, fiscal policy and monetary policy are the tools to improve the situation of cyclical unemployment.
6. Frictional unemployment is another type of unemployment. It refers to job seeking / searching (process) time for workers who are in transition from one to another job.

**2. Complements and Substitutes (12 points)**

The following paragraph is an example of complements and substitutes addressed in the book,

“The Economic Naturalist: In Search of Explanations for Everyday Enigmas” by Robert H. Frank

Please read them carefully, and answer the following questions.

Why do many bars charge patrons for water but give them peanuts for fee?

Some bars charge their patrons as much as $6 for a half-liter bottle of water, while making sure that full bowls of free salted nuts are always within easy reach. Since nuts are more costly to produce than water, shouldn’t it be the other way around?

1. Suppose such a bar makes profit from selling beer. What’s the relationship between salted nuts and water? What’s the relationship between salted nuts and beer? (4 points)
2. Given the relationship between nuts and drink, what would happen to the demand of water if the price of nuts increases? (2 points)
3. Given the relationship between nuts and drink, what would happen to the demand of beer if price of water decreases? (2 points)
4. Does expensive water and free nuts make economic sense? Why or Why not? (4 points)
5. Salted nuts and water are complementary goods. Salted nuts and beer are also complementary goods.
6. If price of nuts increases, the demand for water decreases. (The demand curve shifts to left.)
7. The beer and water are substitutes. Therefore, if the price of water decreases the demand of beer decreases. (The demand curve for beer shifts to left.)
8. Yes, free nuts increase the demand of water and beer. Along with this, expensive water increase demand for beer further. Given bars makes profit from beer, the strategy of expensive water and free nuts makes perfect sense. Comparing to high profit margin from selling beer and water, patrons can earn more profit by providing free nuts.

**Part III: Long Essay (28 points)**

**Money Markets (16 points)**

**“China Easing Case Grows on ‘Grim’ Outlook, Money Supply: Economy”**

**By Bloomberg News on December 14, 2011**

China’s money-supply expanded by the least in a decade and Communist Party leaders described the global outlook as “very grim,” underscoring the case for more monetary easing to support growth.

M2, a broad measure of money supply, grew 12.7 percent in November, the least since 2001, according to data released after an annual economic planning meeting in Beijing today. Local- currency lending of 562.2 billion yuan ($88 billion) was less than in October, the central bank said.

The government indicated today that it won’t back away from curbs on the real-estate industry that are damping house sales and pulling down prices. Risks are rising of a deeper slowdown in the world’s second-biggest economy, the New York-based Conference Board said. So far, China has cut banks’ reserve requirements, while leaving interest-rates unchanged at a three- year high.

“The probability of another reserve ratio cut by year-end is rising,” said Yao Wei, a Hong Kong-based economist for Societe Generale SA.

The nation will target “steady and relatively fast growth” and “basically stable” consumer prices, and “unswervingly” implement real-estate curbs, Xinhua News Agency said after the planning meeting. The statement didn’t include last year’s wording that stabilizing prices would be a “more prominent” part of policies, after inflation cooled from a three-year high of 6.5 percent in July.

1. It is mentioned in the article that M2 is “a broad measure of money supply.” Name one component of M2 that is not included in M1. (3 points)
2. In the article, a “reserve ratio cut” is indicated as a tool to increase China’s money supply. What other two tools that could be used to control the money supply? (4 points)
3. Briefly describe how the central bank of China could use those 3 tools to increase the money supply. (For full credit, you need to explain how each tool works to increase money supply.) (9 points)
4. Saving account (check text book)
5. Discount rate and open market operation.
6. For require reserved ratio tool, increasing r.r.r decreases the amount of loan which banks can lend out; therefore, the money creation process in the flow decreases, making the money supply decrease. (Decreasing r.r.r is analogy)

On the other hand, discount rate is the rate that banks pay for borrowing money to satisfy the r.r.r regulation. If the discount rate becomes high, banks tend to keep more reserve on hand and would not lend as much money out as before. This also decreases the money creation and reduces the money supply. (Increasing discount rate is analogy.)

Finally, Fed directly buy or sell bond on the market. Buying (selling) the bond gives (receive) the money from the market such that the counter parties, bond sellers (buyers), deposit (withdraw) the money into the bank. After money inflow (outflow), banks start to make loans out or reduce their position on loan. The demand deposit increases (decreases) in accordance to adjustment of loans, leading to the increase (decrease) of money supply.

**2. Fiscal Policy (12 points)**

The following paragraphs are selected from an article by CNN NEWS.Please read them carefully, and use what we have learned to answer the following questions.

**Economy**

**The Facts**

The economy, unemployment, taxes and how to manage the federal government's $14 trillion debt will be leading issues in the 2012 campaign. With the near-collapse of the U.S. banking and financial system hitting late in the 2008 race, and the nosedive in employment levels, President Obama's tenure in the Oval Office has been defined, in many ways, by the economy and the worst recession in a lifetime. **Republicans, led by the tea party movement -- the conservative wing of the Republican party -- have been hammering Obama's economic and fiscal policy since 2009, pushing GOP candidates to hold firm on pledges not to raise taxes and to cut spending.** **But headed toward the so-called fiscal cliff –when several rounds of tax cuts expire at the end of 2012, resulting in a half trillion dollars in budget cuts and tax hikes that could push the U.S. into another recession** – Congress and the president are poised for another fight. Obama is seeking to extend the Bush tax cuts for those making under $250,000, but has said repeatedly he is committed to ending the tax cuts for the wealthy. Congressional Republicans may be forced to compromise on a number of the measures up for vote headed into the election if they want to extend any of the cuts. These fights are about to come in front of a Congress that has yet to pass a budget for 2012. The economy remains one of the most important issues for voters, according to a [CNN/ORC poll](http://www.cnn.com/POLITICS/pollingcenter/individual/index.html#2820).

1. Please draw a diagram illustrating the result of ending tax cuts and tightening fiscal policy mentioned above. (4 points)
2. If the marginal propensity to save is 0.1, what are the government spending multiplier, tax multiplier and budget balance multiplier? (3 points)
3. If everyone tends to save more when facing an economic recession, what is the macroeconomic result if everyone changes their saving behavior? (For full credit, you need to draw the diagram to explain) (5 points)
4. Assuming the original equilibrium occurs at intersection of AE0 and 45 degree line, ending the tax cut will decrease the consumption so decrease the AE. Here AE0 thus shifts to AE1. Equilibrium output (GDP) decrease from Y0 to Y1. On the other hand, tightening fiscal policy (cutting budget) also decrease the consumption, leading AE curve shift down. Combining those two effects, the output can decrease further to Y2.
5. Given marginal propensity to save is 0.1, marginal propensity to consume is 0.9.

Government spending multiplier is 1/(1-0.9)=10, tax multiplier is – 0.9/(1-0.9)=-9, buget balance multiplier is 1.

1. If we are in the recession and everyone tends to save more, then marginal propensity to consume decreases, the slope of AE expenditure decreases, leading to output decreases.

If everyone saves more, our economy situation becomes worse.