Final Exam 2002 Solutions

	Form 1	Form 2
1.	d	d
2.	c	c
3.	d	b
4.	d	c
5.	c	c
6.	e	b
7.	b	a
8.	a	c
9.	b	d
10.	b	a
11.	d	d
12.	a	e
13.	e	b
14.	a	a
15.	b	b
16.	b	d
17.	d	d
18.	d	d
19.	c	c
20.	b	d
21.	c	d
22.	c	c
23.	b	e
24.	a	b
25.	c	a
26.	d	b
27.	a	b
28.	d	d
29.	e	a
30.	b	e
31.	a	a
32.	b	b
33.	d	b
34.	d	d

<u>Part B: Short Answer Questions (20 points)</u>

B-1 (True/False/Uncertain—Explanation determines your grade.)

5 points each—4 questions

a. Money growth is the only cause of inflation.

False. There are many causes of inflation. Money growth translates into long run changes in the price level in the quantity theory, but we see from our AS/AD framework that other variables can change P in an upward direction, leading to inflation. Some of these other factors could be supply shocks, increases in AD from G, C, and NX, plus investment deriving from changes other than the money supply (i.e. Changes in the interesta rate from changes in M^d or changes in the overall level of demand in investment).

b. There is no tradeoff between inflation and unemployment.

Uncertain. In the long run, we have a vertical Phillips Curve, but in the short run that tradeoff exists.

c. If everyone saves more, then this will be good for the US economy.

Increases in autonomous saving will decrease consumption. This will shift the AD curve to the left, leading to lower prices and output, plus higher unemployment. But, in the long run this higher savings should translate into more investment and a higher capital stock, which will shift out our LRAS.

d. Thailand's GDP is currently growing at 15%, while US GDP is growing at 4%. Thailand will eventually catch up to the US in terms of GDP.

Uncertain. If Thailand maintains the same growth rate, then yes. If we see diminishing returns in growth rates, then no. The assumption that Thailand has a lower GDP than the US was not necessary for this problem.

B2 Explain the changes in the economy (10 points)

It is 1929 and the stock market has just crashed. Assume that this decrease in wealth lowers consumption, C. As instructed in parts A-D below, fill in the following graphs that describe the economy with the short-run and long-run impacts of such a change in C. Ybar is long run equilibrium GDP.

You must complete parts A-D by finishing the diagrams below.

A. Show the short run changes in AS/AD and label your graph. Label the new short-run values for Y and P as Y_1 and P_1. (3 points)
B. Show the long run changes in the AS/AD diagram. Label the new long-run values for Y and P as Y_2 and P_2. (3 points)
C. Show what happens to Y over time. (2 points)
D. Show what happens to P over time. (2 points)