

Homework Set Fourteen

This is a bonus set. It does not count towards your homework grade. I offer it as a series of homework problems

Explain whether you agree or disagree with these statements. As you will note, in some cases I was lazy and did not state these as agree/disagree problems. Deal with it.

1. Any tax-financed increase in government spending, whether permanent or temporary, will lead to an decrease in consumption demand.
2. There are no important differences between a policy of maintaining a fixed exchange rate and using a currency board.
3. If the government starts increasing the money supply interest rates will fall.
4. To be effective, Monetary Policy Rules must be well publicized.
5. The life cycle model of consumption shows that, both in the long run and in the short run, consumption is proportional to income
6. The money multiplier measures the impact of an increase in the money supply on the Y curve.
7. Whether people work on the short run or long run labor supply curve depends on how long they have been earning their current wage rate.
8. The Theory of Real Business Cycles predicts that real wages will decline during a recession. By the test of “does it fit the facts” it is inferior to the explanation based on unanticipated inflation.
9. A tax on wage income, if it is temporary, will cause people to work less; if it is permanent, it will cause people to work more.
10. $r_R^e = \eta - r_N$
11. The peak of the Laffer Curve shows the optimal level of taxation.
12. If people become more confident about the future, the current deficit on current account will decrease.
13. If the government starts increasing the money supply interest rates will fall.
14. $MV = PY$. Always
15. If we impose a permanently higher tax on wage income, and use the funds to provide services that people value, then there will be no impact on the hours people work.
16. A Phillips Curve gives the relation between expected inflation and employment.
17. The natural rate of unemployment measures the rate achieved at the peak of a business cycle.
18. Inflation robs us all.
19. If people would only love their children more, the trade deficit would fall.
20. If we went back to the Gold Standard, and assuming we could avoid runs on banks like 1929, we would be able to ensure stable prices.

21. The way to increase the incentives to work is to stop taxing wages and start taxing consumption instead.
22. The problem with eliminating income inequality is that it will reduce saving by the wealthy and hence reduce funds available for investment.
23. Elmer Fudd expects to live four time periods. He expects income of \$50,000 and \$100,000 in periods two and three of life. His consumption in period one will be \$25,000 in period one. The discount rate must be 80%
Hint: disagree and give the right number.
24. Elmer Fudd expects to live four time periods. He expects income of \$60,000 and \$90,000 in periods two and three of life. His value of ξ is $1/3$. The nominal interest rate is 125% and the expected inflation rate is 50%. Elmer's demand for money in period 1 will be \$25,000. Hint disagree and give the right number.
25. Eliminating all monopolies will clearly stimulate economic growth.
26. When the Federal Reserve System sells bonds, it increases the money supply and is therefore inflationary. When the US Treasury sells bonds, it must therefore also increase the money supply and must also therefore be inflationary.
27. Gold sells for \$300 an ounce (US). A good loaf of French bread sells for \$3. In West Endwell, a craftsman will sell you a gold necklace with 2 ounces of gold in it for 12,000 Umlats. It takes the craftsman 5 hours to make the necklace, and he expects to earn enough during that period to purchase five loaves of French bread, which currently sells for 600 Umlats a loaf. What is the exchange rate between Dollars and Umlauts? (I am too lazy to word this as an agree-disagree question.)
28. In North Endwell, the interest rate on one year government bonds is 5%; in South Endwell, it is 7%. North Endwell uses the Pico as its unit of currency, and South Endwell uses the Pike. Both North and South Endwell have floating exchange rates, and the current exchange rate is 1 Pico = 1 Pike. What is your best guess as to the exchange rate one year hence?
29. In the summer of 2004, Charles Upton took his family out to dinner in Chaing Mai, Thailand. The bill was 300 Baht. The next evening he took them out again for essentially the same meal in Hong Kong, and the bill was 300 HK \$. The exchange rates were (rounded off for your benefit) 40 Baht = 1 US \$ and 8 HK \$ = 1 US \$. What does this tell you about expected changes in the value of the Baht and the HK \$?
30. Bulgaria, which is not currently a member of the European Union, has a currency board, with its currency pegged to the euro. Was this the right choice? Or should they have adopted a fluctuating currency or pegged to the dollar?
31. An individual who expects to live for four time periods and who has a consumption demand function like that we studied in class expects to earn \$100,000 in period 2 and \$200,000 in period 3 of

his life (and zero in periods 1 and 4). The earnings are stated in real dollars. His value of ξ is $1/3$. The nominal interest rate is 125% and the expected rate of inflation is 50%. His demand for money in period 1 is \$10,000. (Hint: disagree and give me the right number).

32. An individual who expects to live for four time periods and who has a consumption demand function like that we studied in class expects to earn \$100,000 in period 2 and \$200,000 in period 3 of his life (and zero in periods 1 and 4). The earnings are stated in real dollars. His value of ξ is $1/4$. The real interest rate is 50% and the expected rate of inflation is 50%. His demand for money in period 1 is \$10,000. (Hint: disagree and give me the right number).
33. You have just been selected as the minister of economic planning for West Endwell, which has a currency board maintaining an exchange rate of \$1 = 15 Umlauts. You have no authority over the currency board. West Endwell is currently in a recession, with unemployment above the natural rate. You want to cut taxes to stimulate the economy. You have checked and West Endwellians do not have a bequest motive. Assuming that all of West Endwell's GDP is in traded goods, what do you think will happen when you cut taxes?
34. The Washington Post reports that the budget deficit will be \$100 billion less than expected. Assuming that this report is true (and this is an assumption) and that the government does not cut taxes or increase spending in response, this means a higher value of z
35. New research reveals a production function more accurate than the Cobb-Douglas. (That is, the new function does a better job of fitting the facts). This means a higher value of z .
36. New research reveals that the sensitivity of money demand to interest rates is less than previously expected. This means a less steeply sloped M curve.