Exam 2
ECON 3150, Summer 2015

Explain answers if you want any credit. Use graphs and algebra where appropriate. Label graphs clearly. Relative values of the questions are in brackets.

1. [2] Answer *one* of the following:

   (a) True or false: 100% experience-rated UI (where employers' contributions to unemployment insurance are determined completely by the payments made by the UI system to their past employees) would increase unemployment

   (b) True or false: eliminating "at-will" layoffs (the freedom to fire workers for no reason and often with no warning) will reduce unemployment, because people will lose their jobs less often

2. [2] Give the sign of the correlation between each pair of variables. An explanation is only needed on the last pair of variables (for others, just write "+", "-", "positive", or "negative").

%ΔGDP	and	%ΔC
%ΔGDP	and	%ΔI
%ΔGDP	and	u
%ΔC	and	%ΔI
%ΔC	and	u
%ΔI	and	u
%ΔGDP	and	%ΔG

3. [2] True or false: when the central bank increases the money supply, this causes people to buy more stuff because having more money makes them richer. This is why the Fed increases the growth rate of money during recessions.

4. [2] Consider the IS-LM model of Aggregate Demand. For *one* of the following scenarios, explain briefly which curve in the system you should shift first and how AD will shift as a result (if it will). You do not need to explain the effects on the entire system.

   (a) A new tech that increases MPK

(b) An increase in P

5. [2] True or false: monetary policy is better at responding to supply shocks than to demand shocks.

6. [2] Answer *one* of the following

   (a) Do we expect countries with high inflation to have flatter or steeper aggregate supply curves?

   (b) Why is the sacrifice ratio lower in more severe recessions?

7. [2] Can a central bank keep the unemployment rate permanently above the natural rate?

8. [2] Monetary expansion decreases interest rates, and increases in government spending increase interest rates, so how can it be true that both of these policies work to counteract recessions?

9. [4] Use the DAD-DAS framework to analyze the effect of a *temporary* tax cut assuming adaptive expectations. Show what would happen in the short-run and long-run. Graph time-series for output, inflation, real interest rates, and nominal interest rates. How would your analysis change with rational expectations?

10. [2] True or false: Ricardian Equivalence is likely a better model of the effect of a tax increase during a boom than it is for the effect of a tax cut during a recession.

11. [2] Answer *one* of the following:

    (a) True or false: during a financial crisis banks sell off assets because reducing the price of the assets will help stabilize financial markets

    (b) Why did the Fed give/loan huge amounts of money to banks and other financial institutions during the Great Recession even after interest rates were almost zero?

    (c) During recent years, the money base grew substantially, but prices barely grew (and in some quarters even shrunk). How can this happen? What does your answer tell you about why some people are worried about future inflation?

12. [2] Explain how stabilization policy can be destabilizing