Name: **\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_**

ECON 201—Montgomery College

**Exam 2**

* There are 110 possible points on this exam. The test is out of 100.
* You have one class session to complete this exam, but you should be able to complete it in less than that.
* Please turn off all cell phones and other electronic equipment.
* You are allowed a calculator for the exam. This calculator cannot be capable of storing equations. This calculator cannot double as a cell phone.
* Be sure to read all instructions and questions carefully.
* Remember to show all your work.
* Recall basic logic. “Water is wet” is a true statement. “Water is wet and leopards have stripes” is a false statement.
* *Please print clearly and neatly.*

**Part I: Matching.** *Write the letter from the column on the right which best matches each word or phrase in the column on the left. You will not use all the options on the right and you cannot use the same option more than once.*

2 points each.

|  |  |
| --- | --- |
| 1. **\_\_\_** Aggregate demand 2. **\_\_\_** Automatic stabilizer 3. **\_\_\_** Marginal propensity to save 4. **\_\_\_** Monetary multiplier 5. **\_\_\_** Phillips Curve 6. **\_\_\_** Real shock (negative) 7. **\_\_\_** Real shock (positive) 8. **\_\_\_** Short run aggregate supply 9. **\_\_\_** Store of value 10. **\_\_\_** Unit of account | 1. Bigger of this means a bigger shift 2. Cannot be greater than one 3. Example: Food stamps 4. Example: Hurricanes 5. Example: Human capital increases 6. Example: Social Security 7. Money must be portable/divisible 8. Money must be uniform 9. Money cannot rot or decay 10. One reason why monetary policy is hard 11. Shifts if car prices increase 12. Shifts if raw material prices increase 13. Shifts if there is inflation |

**Part II: Multiple Choice.** *Choose the best answer to the following.*

3 points each.

1. One can argue the internet made prices less sticky. Which of the following would ***clearly*** be a logical explanation for this?
2. Consumer expectations are less likely to change
3. Menu costs are lower
4. Contracts last a longer amount of time
5. A & B
6. None of the above
7. If the reserve requirement (aka reserve ratio) is 20% and the MPS is 0.1, what is the monetary multiplier?
   1. 1.25
   2. 5
   3. 10
   4. 20
   5. None of the above
8. According to the signaling theory for why more education leads to a higher income, if this class was famously difficult, which students would be better off?
9. All students would be better off because they would learn so much more.
10. Only the best students would be better off.
11. Only the students planning to be economists would be better off.
12. No students would be better off, but no one would be worse off.
13. All students would be worse off.
14. If the U.S. dollar becomes less valuable, what happens in the U.S. economy?
    1. AD shifts
    2. LRAS shifts
    3. SRAS shifts
    4. A & B
    5. A & C
15. Which of the following tax policies would act as an automatic stabilizer?
16. An annual tax of $50 from each person.
17. An annual 10% tax to the value of all owned jewelry.
18. An annual 15% tax on all incomes.
19. A & C
20. None of the above
21. Which of the following is an example of adverse selection?
    1. Buying a laptop you know won’t work.
    2. Voting for an honest politician who then uses his influence unethically.
    3. Adopting a dog who turns out to have a bad temper.
    4. A & C
    5. None of the above
22. Which of the following would cause the U.S. AD to shift right?
    1. The government spends more, funded by increasing taxes.
    2. Incomes in China, Europe, and other countries fall due to a recession.
    3. Scientists discover a new energy source which can be implemented immediately.
    4. A & B
    5. None of the above
23. Economists often debate the size of the fiscal multiplier, particularly when there’s a recession. What is the significance of this debate?
24. A large fiscal multiplier means unemployment will stay high.
25. A large fiscal multiplier implies there will be a lot of inflation.
26. A large fiscal multiplier ensures fiscal policy will be very effective.
27. B & C
28. None of the above
29. Consider the fictional island nation of Mepos, where fishing is the main industry. The government uses a progressive tax system much like the United States. For taxable incomes up to $20,000, the marginal tax rate is 10% and 20% beyond that. If a fisherman makes $50,000 in taxable income, how much does he owe in taxes?
30. $5,000
31. $8,000
32. $10,000
33. $12,000
34. None of the above
35. Some individuals argue that fractional reserve banking is inherently unstable. Suppose we did away with fractional reserve banking, setting the reserve requirement (aka reserve ratio) to 100%. How would this change alter the effectiveness of open market operations?
    1. It would completely eliminate any effectiveness
    2. It would significantly hinder its effectiveness
    3. It would have no change on its effectiveness
    4. It would enhance its effectiveness
    5. It is impossible to tell with the information provided
36. What is the federal funds rate?
37. The rate banks borrow from the Fed.
38. The rate banks borrow from each other.
39. The rate banks buy government securities from the Fed.
40. The rate banks buy government securities from each other.
41. None of the above
42. Which of the following could cause cost-push inflation?
    1. Too much hard currency in circulation.
    2. The price of laptops suddenly and dramatically increases.
    3. The price of a variety of goods and services rise.
    4. B & C
    5. None of the above
43. Suppose there’s an expected increase in inflation. Who does this increase in inflation hurt?
44. Borrowers
45. Savers
46. Creditors
47. B & C
48. No one
49. Suppose the velocity of money increased and GDP was the same. What could happen?
50. The supply of money falls
51. Inflation
52. Deflation
53. A and/or B
54. None of the above

**Part III: Short Answer.** *Answer the following.*

12 points each.

1. Below is a table of hypothetical data concerning various factors about various economies. Assume all factors matter equally for purposes of determining currency value. On the lines below, rank the currencies in order starting with the one that is getting the most valuable (note this could mean the currency is depreciating; it’s just depreciating less than the others). For each currency, indicate if it is appreciating or depreciating.

Do not include the Rest of the World in your ranking; you are only ranking these six countries.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| *Country’s Currency* | *Domestic Price Level* | *Domestic Productivity* | *Domestic Interest Rate* | *Domestic Demand for Imports* | *Foreign Demand for Exports* |
| Rest of the World | +2% | +1% | +2% | +1% | +3% |
| Chinese yuan | +3% | -1% | +5% | +0% | -3% |
| Japanese yen | +2% | +3% | +1% | +2% | +1% |
| North Korean won | +5% | -3% | +0% | +6% | -1% |
| Russian ruble | +2% | +1% | -2% | -3% | -5% |
| South Korean won | +0% | +4% | -1% | +3% | +2% |

1st \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_

2nd \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_

3rd \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_

4th \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_

5th \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_

6th \_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_

1. Briefly explain how the Federal Reserve engages in monetary policy using its most commonly used tool. (Make sure to identify what this tool is called in your answer.)

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1. Consider the AD-AS diagram of an economy below. Illustrate the effect of (1) a terrible drought which affects most of the country, (2) expansionary fiscal policy in response to that drought, and (3) the long-run effect of that policy. You should label each shift to make the order clear.

YR

LRAS

SRAS

AD

PL

1. Consider the AD-AS diagram of an economy below. Illustrate the short and long run effects of a drop in the real interest rate due to an increase in the money supply. You should label each shift to make the order clear.

YR

LRAS

SRAS

AD

PL