Essay Questions

Chapter 1

1. What are the three methods of GDP accounting? Briefly describe each.

2. Distinguish between *open* and *closed* economies. How does the basic GDP accounting identity differ in the two cases?

Chapter 2

1. What is consumption smoothing? Explain using an example.

2. Let Y_1 denote current period income and Y_2 denote future income. For each of the following two cases, draw the household's utility-maximizing diagram, and show on the diagram how much saving is undertaken.

Chapter 3

1. What is consumption smoothing? Explain using an example.

2. Consider a firm that invests I resources today, and produces Y amount of output tomorrow. The firm invests by borrowing an amount I today, for which it has to bear an interest cost of r. Use a diagram of the firm's production possibilities set to show why the firm's demand for investment curve will be downward sloping with respect to the interest rate.

Chapter 4

1. Use the saving and investment diagram to explain why the U.S. trade deficit and the federal budget deficits both increased in the 1980s.

2. Explain the proposition of *Ricardian equivalence*.

Chapter 5

1. What is liquidity preference?

2. Suppose you are considering allocating your portfolio between two assets: money and corporate stocks. What features of these assets would you consider in making your decision?

Chapter 6

1. What do you mean by the liquidity of an asset? Provide some examples.

2. What is the connection between the liquidity of an asset and its rate of return? Explain using examples.

Chapter 7

1. What is the LM curve? Which economic variables do we hold constant along the LM curve?

2. Analyze the effect of an increase in the output elasticity of money demand upon the LM curve.

Chapter 8

1. Explain in a paragraph the essential features of the Classical Theory of Aggregate Supply.

2. What is the Laffer curve? What do supply-siders assume about the position of the revenue maximizing tax rate relative to current tax rates? What is the implication of this assumption?

Chapter 9

1. You have been asked to analyze two competing explanations of business cycles. One explanation claims that business cycles are caused by productivity fluctuations. An alternative explanation says that the business cycles are caused by shifts in households' preferences. Using a demand-supply diagram for the labor market, evaluate these two competing explanations in terms of their implications for employment, output and the real wage rate.

2. Describe how the Real Business Cycle Theory uses the Classical Theory of Aggregate Supply to explain business cycles. What are the main drawbacks of this theory?

Chapter 10

1. Explain what is meant by frictional unemployment using the concepts of stock and flow variables.

2. How does the efficiency wage theory explain the existence of unemployment?

Chapter 11

1. Distinguish between a fixed and a flexible exchange rate system.

2. Briefly describe how the international exchange rate system has evolved since the Bretton Woods agreement.

Chapter 12

1. Is fiscal policy always ineffective with flexible exchange rates?

2. Would accommodative monetary policy help stimulate output after a currency devaluation?

Chapter 13

1. Why would an exchange rate appreciation allow the NAIRU to be sustainable at a lower level of inflation?

2. How is the Competing Claims Equilibrium determined?

Chapter 14

1. How can a fixed exchange rate regime enforce inflation discipline?

2. Why might a country decide to join an Optimal Currency Area?

Chapter 15

1. Why might a nation defend its currency?

2. Why though did Latin America do so badly in the aftermath of a currency crisis compared to Europe?

Chapter 16

1. When is a production function said to satisfy constant returns to scale? What is meant by diminishing marginal returns to a factor input? Give an example of a production function and show how you would distinguish between these two concepts.

2. Figure 1 below plots output per person against input per person for the U.S. during the period 1929-90.

a. If output were produced according to a constant returns to scale production function, what would a representative production function look like?
b. Given your answer to (a), what does the scatter plot below tell us about technological progress and why?

c.   How does the neoclassical production function incorporate such technical progress?
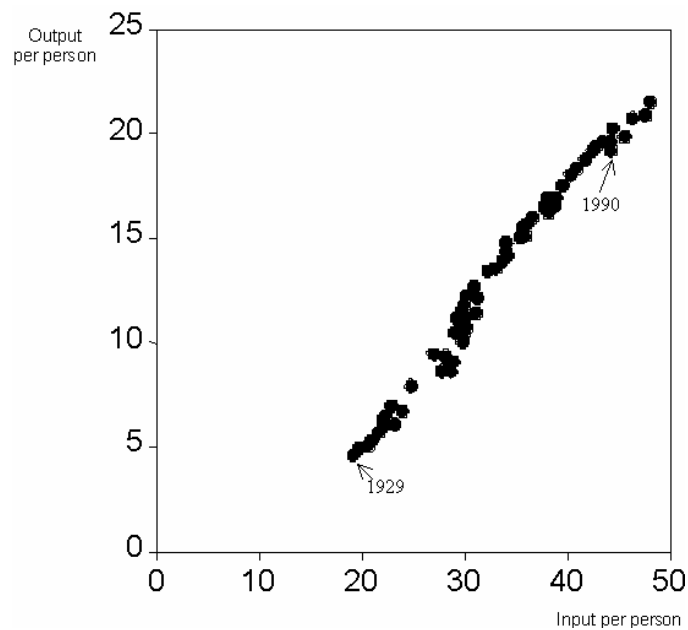

Figure 1

Chapter 17

1. Is economic growth associated with poverty reduction?

2. What are the key differences in the approach to economic growth of East Asia and Latin America?