

Part I- Multiple Choice. (15 questions; 85 points).

Which of the following is NOT considered by economists to be a welfare cost of inflation?

- a. that it leads to lower economic growth over time. ✓
- b. that it tends to harm the poor more than the rich. ✓
- c. that it generates inefficiencies such as menu costs. ✓
- d. that it reduces the international competitiveness of domestic goods. ✓
- e. that it prompts governments to undertake expansionary policies.

Relative to others, debtors _____ from unexpected inflation.

- a. gain
- b. lose
- c. experience a reduction in purchasing power
- d. experience a loss in the portion of their income that is fixed only.
- e. suffer from severe uncertainty.

$$\begin{matrix} T > G \\ PI > S \end{matrix}$$

$$\begin{matrix} G > T \\ S > PI \end{matrix}$$

Suppose the economy is in equilibrium and that $G < T$. Given this information, and using the injections/leakages approach to equilibrium, we know that

- a. $S = PI$. ✗
- b. $S > PI$. ✗
- c. leakages must be greater than injections
- d. the government can use its savings to pay back part of the debt.
- e. none of the above

The reason firms keep inventories of finished goods is that this is part of a good _____ plan.

- a. stabilization
- b. classical
- c. money supply
- d. Keynesian
- e. management

When output is _____ planned aggregate spending, there is _____ inventory investment.

- a. equal to; stabilizing
- b. greater than; unplanned negative
- c. greater than; unplanned positive
- d. less than; unplanned positive
- e. none of the above

$$\begin{matrix} Y > PAE \Rightarrow +ve \\ Y > PAE \Rightarrow + \end{matrix}$$

$Y > PAE$
 $\Rightarrow +ve$ change
Supply > demand.

Which of the following is NOT a correct statement according to economists?

Answer →

- a. Investment includes activities such as the purchase of stocks or bonds. ✓
- b. When banks lend money to firms this is not considered investment (for the banks) as formally defined.
- c. Firms invest when they acquire additional unplanned inventories.
- d. To invest is to acquire or produce something that can create future value. ✓
- e. Firms invest when they acquire new machinery or build new plants. ✓

Changes in taxes or spending that occur automatically without deliberate changes in government policy are called _____ policies.

non-dis

- a. nondiscretionary fiscal
- b. discretionary fiscal
- c. nondiscretionary monetary
- d. discretionary monetary
- e. welfare compensation

In several recent years, the Lebanese government managed to achieve a surplus in its budget. Despite that, the public debt problem is still huge. This apparent contradiction is easily explained by the fact that

- a. The volume of the public debt in this country is simply too large relative to other public debts around the world.
- b. The volume of the deficit in this country is simply too large relative to other deficits around the world.
- c. The public debt can only decrease if foreign governments assist the country to pay it all back.
- d. The reported numbers are misleading.
- e. The surplus was probably used to pay part of the debt but is hardly sufficient to pay all of it.

When planned aggregate expenditure declines in an economic crisis, Keynesians would advise the government to implement a(n)

- a. contractionary fiscal policy to address the problem of inflation.
- b. contractionary monetary policy to address the problem of inflation.
- c. expansionary fiscal policy to increase output
- d. non-discretionary fiscal policy
- e. none of the above

stimulate the ec

Assume aggregate consumption is $C = 200 + .75Y$ and planned investment is \$250 billion. If aggregate income is \$1000 billion, then the unplanned inventory change is \$ _____ billion.

- a. 0
- b. 200
- c. -200
- d. 100
- e. -100

$$PAE = C + PI = 1200$$

$$Y = 1000$$

$$PAE > Y \Rightarrow \text{-ve change}$$

$$PAE > Y \text{ by } 200$$

Assume that $C = 100 + .8(Y - T)$, taxes are \$100 billion, government purchases are \$200 billion, and planned investment is \$100 billion. Then an output of \$1,600

- a. Leads to no unplanned changes in inventories
- ~~b. is below the equilibrium level of output.~~
- ~~c. is above the equilibrium level of output.~~
- d. prompts firms to increase their output.
- e. none of the above

$$Y^* = 1600$$

$$Y^* = \left(\frac{1}{1-b}\right)(a + PI + G) + \left(\frac{b}{1-b}\right)T$$

$$= \left(\frac{1}{1-0.8}\right)(100 + 100 + 200) + 100$$

$Y = Y^*$
Equilibrium

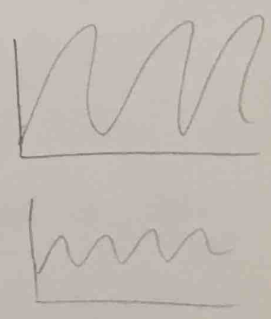
$$Y^* = 1600$$

The fact that the balanced-budget multiplier is one has

- a. supported the Keynesian arguments that government spending can be effective without increasing the public debt
- b. supported the Keynesian arguments that government spending must always be fully covered by taxes
- c. supported the neoclassical arguments that government spending is wasteful
- d. supported the neoclassical arguments that government spending cannot increase aggregate output
- e. None of the above

The existence of programs such as welfare and unemployment compensation and a tax system that is progressive are things that make an economy

- a. less likely to have inflation than otherwise
- b. less likely to go through recessions than otherwise \times
- c. more likely to have a large debt than otherwise \times
- d. less likely to experience dramatic fluctuations in disposable income than otherwise
- e. None of the above



Even in good economic times, there will always be a positive unemployment rate. One of the reasons for that is:

- a. there are new entrants into the labor force every year
- b. some women decide to stay home and take care of their children despite the fact that they may have marketable job skills. *x*
- c. some individuals eventually stop searching if they cannot find work after a while. *x*
- d. a percentage of the labor force retires every year.
- e. cyclical unemployment is never zero.

Which of the following ^{skills - technology} situations is most likely to lead to an increase in structural unemployment?

- a. The reduction in job opportunities due to a recession. *physical*
- b. An increase in the numbers of university graduates. *functional*
- c. Erratic business cycles. *x*
- d. Major technological changes.
- e. All of the above are associated with structural unemployment.

Part II- Essays/Problems (40 points): Answer the following two questions (20 points each)

1) The following questions pertain to unemployment: a) Briefly explain the four different types of unemployment. b) Why do economists think that some unemployment is inevitable? c) Give an example of a public policy that may be used to reduce the part of unemployment that is inevitable.

2) Assume an economy is represented by the following:

$$C = 500 + .75Y_d$$
$$PI = 800$$

$$G = 1000$$
$$T = 1000$$

- (a) Suppose actual output is 5000. What is the level of planned expenditures at this level of output? ✓
(b) Are there any unplanned changes in inventories at this level of output? If so, indicate how much and whether negative or positive. Briefly explain the implications.
(c) Calculate the equilibrium level of output.
(d) Suppose that G and T simultaneously increase by 300. Calculate the new equilibrium level of income USING THE SHORTEST ROUTE.

2) a) $PAE = C + PI + G$
 $= a + bY_d + PI + G$
 $= 500 + 0.75(5000 - 1000) + 800 + 1000$
 $PAE = 5300$

$Y_d = Y - T$

b) $PAE > Y : 5300 > 5000$

The demand exceeded the expectations in this case, so in order to meet the higher demand the firms will more likely to produce more to refill the gap and use some of the inventories that are in the warehouse & hence there will be a negative change in the unplanned⁶ inventory investment because it will decrease (used to refill the gap between the demand & supply) and the change is 300 (difference between supply & demand)

20

firms are likely to produce more and this requires more workers so the unemployment rate will decrease

$$c) Y^* = \left(\frac{1}{1-b}\right)(a + PI + G) + \left(\frac{-b}{1-b}\right)(T)$$

$$= \frac{1}{1-0.75} (500 + 800 + 100) + \left(\frac{-0.75}{1-0.75}\right)(1000)$$

$$\boxed{Y^* = 6200}$$

d) If G & T increased simultaneously this means that the economy follows the budget. ^{balanced}

$$G = T \Rightarrow \Delta G = \Delta T = \Delta B = 300$$

$$\text{so } \Delta Y^* = 1 \times \Delta B$$

$$\Delta Y^* = 1 \times 300$$

$$\boxed{\Delta Y^* = 300}$$

1) The four unemployments are:

* Seasonal: Where there are fluctuations with seasons and some workers are unemployed because of the seasonal changes like the tourism industry and the farmers that depend their products on season

* Frictional: All the reasons caused by the frictions in society such as people reentering the labor market, people looking for better work, fresh graduates, or people moving from the village to the city; these caused tension in society ^{to} result in an unemployment

* Structural: that is the mismatch between the workers' skills and the demand in the labor market ~~where~~ due to the high tech skills that present now and the technological

advancement that is continuously improving.

x cyclical: where there is unemployment in the market due to the low investment that was a result of political war (unstable) or economic recession.

Economists think that the kind of unemployment that is inevitable is all the non-cyclical unemployment (natural) that are frictional, seasonal, & structural. They think it's inevitable because ~~the~~ even if the economy is functioning well, there will be always changes that aren't under the control like seasonal changes, ~~frictions~~ frictions in society, and technological changes.

The public policy for the structural are training centers that can improve the skills of the workers. As for the seasonal we can increase the flow of information so that farmers / tourists be aware of the changes and consequences. And last but not least, for the frictional we can use job fairs that can guide people in the labor market.