

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 1) During a recession, would classical economists propose that changes in government spending or taxes be used to improve economic conditions? Briefly explain.
- 2) Why might firms pay an efficiency wage rather than a market-clearing wage?
- 3) If you were president of the United States, what would you do to reduce the natural rate of unemployment? Propose at least three different methods.
- 4) Describe the major costs of inflation, being sure to distinguish between anticipated and unanticipated inflation.
- 5) In the Keynesian model in the short run, what is likely to happen to employment after each of the following shocks?
 - (a) An increase in taxes
 - (b) An increase in consumer spending generated by a reduced desire for saving
 - (c) An increase in the money supply
- 6) Draw a saving-investment diagram to show how each of the following changes shifts the *IS* curve.
 - (a) Future income rises.
 - (b) The future marginal productivity of capital increases.
 - (c) Government purchases decrease temporarily.
 - (d) The effective corporate tax rate increases.
- 7) Use the classical (RBC) *IS—LM—FE* model to show the effects on the economy of a temporary beneficial supply shock; for example, a decrease in the price of oil. You should show the impact on the real wage, employment, output, the real interest rate, consumption, investment, and the price level.
- 8) Analyze the short-run and long-run effects of an unanticipated decrease in the money supply in the misperceptions model. Tell what happens to output, the price level, and the expected price level in both the short run and long run.
- 9) Use the classical (RBC) *IS—LM—FE* model to show the effects on the economy of a temporary adverse supply shock; for example, an increase in the price of oil. You should show the impact on the real wage, employment, output, the real interest rate, consumption, investment, and the price level.