Intermediate Macroeconomic Policy
Mid-Term Exam
2003

Please answer all questions. Although time is limited, try not to use too much shorthand in your answers.

1. What is the distinction between real and nominal GDP? Explain the dangers of confusing the two when (a) comparing the GDP of two countries in a given year, and (b) comparing the GDP of a country in two different years.

2. Within the framework of the classical model, what are the (a) immediate effects, and (b) long-term effects, of an increase in the level of taxes collected by the government?

3. Suppose that central bank A cares only about keeping the price level stable, and central bank B cares only about keeping output and employment stable. Explain how each central bank would respond to an increase in consumer confidence.

4. In the framework of the classical model we have assumed that government expenditure is a policy variable that we treat as purely exogenous. But a significant part of government expenditure depends directly on output. In good times, government expenditure goes down, while in bad times it goes up. We can write this as $G=G(Y)$, with $dG/dY<0$. Incorporate this extension to the classical model in your analysis of the effect of a sudden increase in the capital stock on the real rate of interest.

5. It has been noted that, when a country pegs the value of its currency to a fixed quantity of gold, discoveries of gold are more likely during periods of deflation. Provide a rationale for this phenomenon.

6. (a) In what sense is monetary policy neutral? Why is monetary policy useful even though money is neutral? (b) Fiscal policy, just like monetary policy, cannot induce permanent deviations of output from its potential level. Why then is monetary policy considered neutral but fiscal policy is not?