

Final Exam  
ECN 150  
Wake Forest University  
Fall 2010  
Instructor: McFall

Instructions- You have 120 minutes to complete this exam. Answer each question succinctly and completely.

1. The table below lists output for all goods produced in Deaconville in 2000 and 2009. Prices of the four goods in 2000 were 400 for shelter, 20 for food, 10 for drink, and 25 for clothes. Additionally, when 2000 is considered the base year, the consumer price index in 2009 has a value of 115.

	Shelter	Food	Drink	Clothes
2000	40	500	600	110
2009	42	520	620	120

- a) From the information given above, estimate Deaconville's nominal GDP for 2009.
  - b) From the information given above, using 2000 as the base year, estimate Deaconville's real GDP for 2009.
  - c) What problems arise from using the CPI and GDP as measures of price changes or national income changes in the aforementioned calculations?
2. On January 1, 2010, Amanda signed for a \$1000 loan from Deaconville Bank & Trust. The bank and Amanda agreed to a 10% nominal interest payment. The loan and interest was to be paid back in entirety on January 1, 2011. Both parties thought inflation was going to be 6% at the time the loan was granted. It turned out that inflation was actually 4%.
- a) Who, if anyone, benefited from this miscalculation? Who, if anyone, was harmed by this miscalculation? Explain.
  - b) What instructive point regarding credit markets does this example illustrate?
3. Deaconville is a democratic republic with laws that enforce citizens' rights to hold private property. Blue Devil Hills is governed by a politburo that manages the country's economic decisions closely. Both economies have large untapped resources and, at the moment, have similar per capita incomes. Why might Daron Acemoglu argue that Deaconville will be eventually the more robust of the two economies?
4. The central bank in the US is known as the Federal Reserve System. We have discussed that one of its responsibilities is to guard the perception of the value of the US dollar. For the sake of long run growth in the US, why is it important that the Federal Reserve meets this responsibility?



5. The following paragraph was taken from David Walker's essay titled "Cleaning up America's Fiscal Policy":

Let's take the example of kids born in early 2000, when our national budget was in balance and the technology-powered future seemed bright

During the first eight years of their lives, we have learned, the nation's financial hole grew by 176 percent to \$56.4 trillion. And the number is not standing still. That was its size as of September 30, 2008 - before the official declaration of a recession, before the significant market declines of October 2008, and before the big stimulus and bailout bills designed to jump-start the economy and address our immediate financial crisis. In fiscal 2007, recall, our budget deficit was \$161 billion, or 1.2 percent of the economy. By 2009, the deficit soared to \$1.42 trillion, which is about 9.9 percent of the economy. Just think about that for a second. Our federal deficit grew by almost nine times in the past two fiscal years!

Respond to these two paragraphs.

- a) Why did what he describes happen?
- b) Why is this problematic for the future of the US economy?
- c) What is one option for reducing the size of US deficits? Why doesn't the government take up your suggestion?

6. Imagine Federal Reserve Chairman Ben Bernanke called you to ask for advice on how the Federal Open Market Committee should act during the current economic malaise.

- a) Besides simply printing more money, what tools does the Federal Reserve have at its disposal for conducting monetary policy decisions? Describe briefly the purpose of each tool.
- b) What advice would you provide to Chairman Bernanke?
- c) What tradeoffs exist for the Fed should it choose to take your advice?
- d) How do these trade-offs differ from the tradeoffs that the Fed faced when it fought stagflation in the late 1970s?