Economics 470/570 **Name: ______________________________**
Fall 2006 **(1 bonus point if name is on *all* exam pages)**
Final Exam

Part I - Definitions. Define each of the following (2 points each, 12 points total).
1. FOMC
2. Dynamic and defensive open-market operations
3. Quantity equation
4. Activists and non-activists
5. Implementation lag and effectiveness lag
6. Natural rate hypothesis

Part II Answer FOUR of the following questions (7 points each, 28 points total).

1. How is money measured? Why is there more than one definition of the money supply?

2. Show that the Fed cannot continuously hit both a money supply target and an interest rate target, i.e. that it must choose one or the other.

3. Explain the Monetarist view of aggregate demand. Explain why Monetarists do not believe that shifts in the IS curve affect aggregate demand.

4. Is the economy self-correcting?

5. Why does the short-run aggregate supply curve slope upward? What factors cause the short-run aggregate supply curve to shift?

Part III Answer FOUR of the following questions (15 points each, 60 points total)

1. How has the power structure of the Fed shifted over time?

2. Use the IS-LM model to show that fiscal policy becomes more effective relative to monetary policy as investment becomes less sensitive to the interest rate. Explain the result intuitively. What does this imply about the use of monetary and fiscal policy over the business cycle?

3. Do Monetarists agree with Friedman's contention that inflation is always and everywhere a monetary phenomenon? Explain using the AD-AS model. Do Keynesians agree with Friedman? Explain.

4. Explain how the pursuit of a high employment target can lead to inflation.

5. Suppose the monetary authority wants to reduce the inflation rate. Compare the costs (in terms of output) of reducing inflation in the traditional Keynesian, New Classical, and New Keynesian models. Be sure to cover both an expected and an unexpected change in policy. Why is the credibility of policymakers important?