Professor Salyer, Economics 137, Spring 2003

Final Exam

Directions: Answer all questions. Point totals for each are given in parentheses. Remember, to receive full credit you must provide ***complete explanations*** *for your answers. Relax and Good Luck. And, most important, enjoy your summer — after exams are over.*

1. (20) Contrast Ricardian Equivalence and the Tax Smoothing Hypotheses. In particular, discuss how it is possible for economists to reach such different conclusions in the analysis of fiscal policy? In your answer, be sure to identify the thought experiment associated with both theories.

2. (20) What in God's name is the "intertemporal Euler equation" and what does it have to do with monetary policy?

3. (15) In Euroland, businessmen are prone to waves of skepticism and optimism which translates into their investment decisions. Based upon Poole's analysis, should the European Central Bank target the money supply, inflation, nominal GDP, or interest rates? Use graphs to support your answer.

4. (10) Canada and the United Kingdom have both adopted a policy of inflation targeting. Why in heaven's name would they do such a thing?

5. (15) In the tax bill that was recently signed into law by President Bush, the tax rate on corporate dividends will be reduced. Many economists, using empirical analysis, have forecast that this policy change will increase the demand for stock and, therefore, result in an increase in stock prices. Do you believe this forecast? (Base your answer **solely** on topics and theories discussed in class.)

6. (10) Give the dates (roughly) of four recessions since the end of the Korean War.

7. (15) In the paper by Clarida, Gali, and Gertler, they derived a simple relationship between inflation and the output gap implied by optimal monetary policy. This relationship is:

$$x_t = -\frac{\lambda}{\alpha}\pi_t$$

What is the intuition behind this rule? What is the implication for monetary policy?

8. (15) Analyze the following quote: “From the context of the Taylor rule, it appears that the Fed did a poor job in conducting monetary policy in the 1970’s.”