Professor Salyer, Economics 137, Spring 2002

Midterm Exam

Directions: Answer all questions - point totals for each question are given in parentheses. For full credit, you must provide complete explanations for your answers.

1. (20) In discussing the history of post-WWII fiscal policy, Christina Romer discusses two features that "have yielded an actual government budget surplus that is decidedly procyclical in the postwar era." What are these features and what is the relevance for stabilization policy.

2. (15) Assume that the yield curve is currently:

maturity (years)	yield
1	2%
2	2%
3	5%
4	7%
5	4%

   Given this data and based upon the expectations hypothesis, what is the two-year interest rate expected to be two years from now.

3. (20) You are hired as an economic consultant for the Bush administration and are told that a tax cut is being considered to stimulate the economy. You raise some reservations about this proposal based upon the tax-smoothing hypothesis - your argument goes as follows....

4. (10) Fed policy changed dramatically during the period 1979-82. Describe the nature of this change and the events that motivated it.

5. (20) Bob lives for three periods and has utility function of:

   $$U(c_1, c_2, c_3) = \ln c_1 + \beta \ln c_2 + \beta^2 \ln c_3$$

   Bob has an income of 3 units in his first period of life and earns nothing in periods 2 and 3. Suppose that the current one-period interest rate is 12% and $\beta = 1/1.12$. How much does Bob consume each period?

6. (20) In discussing the high inflation of the 1970's, Christina Romer states that fiscal and monetary policymakers may have overexpanded simply because they did not understand the trade-offs they faced. What does this mean?

7. (15) The growth rate of the money supply has become more erratic in recent years. Using the model of the money supply developed in class, provide an explanation for this behavior.