Review for final challenge
Eco 212
Spring 2006

As usual, the format of the challenge is 5-6 short answer questions (1-2 sentences) and 2-3 longer questions (usually requiring a graph, some math, and/or a longer explanation). The challenge is closed book. All questions come from the class notes. Also study homework 4, chapters 10-14, and this review sheet. Remember, you must understand the reasoning behind the relationship between AD, interest rates, C, I, and $X - M$ and the spending balance graph. The schedule has the final challenge on Thursday, May 11 from 8 am to 10:30 am in the same room as class. I will have the usual office hours (Wednesdays, 2-3 or by appointment).

Short answer questions (1-2 sentences)

Question 1

Define "neutrality of money." Explain why money is likely to be neutral in the long run.

Question 2

Suppose the US economy experiences a short run recession followed by long run lower inflation. According to the model developed in class, which of the following events could have caused this situation? **Explain**.

a. A decrease in government spending financed by reduced taxes.

b. An increase in government spending, financed by borrowing.

c. A decrease in government spending, financed by reduced borrowing.

d. An increase in the inflation target.

Longer Questions

Question 3.

Suppose the US economy is in a recession caused by a fall in investment. Which of the following strategies should the government adopt? Graphically show the effect of your chosen policy in the short and long run on the spending balance and AD-AS graph. What happens to inflation, interest rates, consumption, investment spending, net exports, capacity utilization, unemployment, and income in the short and long run?

a. Decrease the inflation target.

b. Raise taxes.

c. Cut taxes.

d. Negative price shock.

Question 4.

What policy would you recommend the government adopt to reduce inflation? Graphically show the effect of your policy in the short and long run on the spending balance and AD-AS graph. What happens to inflation, interest rates, consumption, investment spending, net exports, capacity utilization, unemployment, and income in the short and long run?