

Econ 1: Spring 2012: Problem Set 8

Due at the first section after the April 23, 2012 Lecture

1. Explain whether or not, why, and how the following items are included in the calculation of GDP:

a. Increases in business inventories.

b. Fees earned by real estate agents on selling existing homes.

c. Social Security checks written by the government.

d. Building of a new dam by the Army Corps of Engineers.

e. An economist earning \$2,000 by giving a speech to members of San Francisco's *private* Commonwealth Club.

f. Interest that your parents pay on the mortgage they have on their house.

2. Calculating real magnitudes:

a. When you calculate real GDP, do you do so by dividing nominal GDP by the price level or by subtracting the price level from nominal GDP?

b. When you calculate the real interest rate, do you do so by dividing the nominal interest rate by the price level or by subtracting the inflation rate from the nominal interest rate?

c. Are your answers to the two parts the same? Why or why not?

3. Suppose that the appliance store buys a refrigerator from the manufacturer on December 15, 2010 for \$600, and that you then buy that refrigerator on February 15, 2011 for \$1000:

a. What is the contribution to GDP in 2010?

b. How is the refrigerator accounted for in the NIPA in 2010?

c. What is the contribution to GDP in 2011?

d. How is the refrigerator accounted for in the NIPA in 2011?

4. Solve for the equilibrium level of real GDP Y in the Keynesian framework where: $Y = C + I + G$, $C = c(o) + c(y)Y$:

a. With $c(o) = \$5$ trillion/year, $c(y) = 1/3$, $I + G = \$5$ trillion/year

b. With $c(o) = \$4$ trillion/year, $c(y) = 1/3$, $I + G = \$5$ trillion/year

c. With $c(o) = \$5$ trillion/year, $c(y) = 1/3$, $I + G = \$4$ trillion/year

d. With $c(o) = \$4$ trillion/year, $c(y) = 1/2$, $I + G = \$4$ trillion/year

e. With $c(o) = \$4$ trillion/year, $c(y) = 1/2$, $I + G = \$6$ trillion/year

5. Suppose that the government has decided that it wants to boost the equilibrium level of real GDP Y , is working within the Keynesian framework, and is deciding whether it will try to do this by increasing the level of G , of I , or by increasing $c(o)$. What is the principal argument for preferring to attempt to increase G rather than I or $c(o)$? What is the principal argument for preferring to attempt to increase I rather than G or $c(o)$? What is the principal argument for preferring to attempt to increase $c(o)$ rather than G or I ? How should a government working within the Keynesian framework implement these plans?

6. Minskyites tend to say that both Keynesians and monetarists are wrong-----at least in dealing with deep depressions. From their perspectives, attempts to boost either the economy's money stock or the planned amount of (risky) investment in building firm capacity are likely to fail to relieve depression. What is the Minskyite story for why normal monetarist attempts to cure depression by printing money are unlikely to be completely successful? What is the Minskyite story for why normal Keynesian attempts to cure depression are unlikely to be completely successful?

7. Classify each of the situations below into one of our three types of depression: monetarist, Keynesian, and Minskyite:

a. Very low interest rates on short-term and long-term government bonds, but high interest rates on risky corporate bonds and low stock prices.

b. Very high interest rates on short-term and long-term government bonds, high interest rates on risky corporate bonds and low stock prices.

c. Very low interest rates on short-term and long-term government bonds, low interest rates on risky corporate assets and depressed stock prices.

d. Very low interest rates on short-term government bonds, high interest rates on risky corporate bonds, low stock prices, and high interest rates on long-term government bonds.