

Instructions:

1. This exam is open-book. You may use any written materials that you think are appropriate, including class notes, readings, or other published material. You may not communicate with anyone other than the instructor in any way about the exam until after the deadline.
 2. Make sure that you understand the meaning of each question. If you are not sure, consult the instructor.
 3. Be careful to cite appropriately in your answers. When citing something on the reading list, you may just use author and date; if you cite something else you should include full bibliographic information.
 4. Your answers may be submitted electronically or brought to Vollum 229. If the instructor is not in the office when you drop off your exam, please slide it under the door.
 5. Have a wonderful summer!
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1. Using the resources of the Reed Library, propose a paper that you think would have been a good addition to the reading list for this course. The paper may be published in an economics journal or may be a scholarly working paper issued by NBER, CEPR, the Fed, or an academic economics department. Articles from journalistic sources such as *The Economist* and the financial or general press are *not acceptable* for this question. Searchable databases on the Library Web site such as EconLit and Web of Science may be helpful in finding appropriate papers. (Dena Hutto's economics research guide may be a useful resource: <http://library.reed.edu/instruction/economics/09seconsem/>.)

The criteria for selection should include (a) coverage of a relevant topic connected to (but not duplicated by) other readings and (b) comprehensibility by class members, many of whom have not taken advanced macroeconomics or econometrics courses. I will evaluate your selections based on these criteria.

Your answer to this question should include (a) full bibliographic information and the authors' abstract, (b) a brief discussion of what, if any, sections or aspects of the paper would be difficult for the average student in the class to understand, (c) a brief discussion of how this paper would fit topically with other readings on the syllabus and what it would add to the course, and (d) a brief (one-page or so) review/summary of the paper,

2. Suppose that a bank with low capital and full deposit insurance begins to undertake very risky investments that increase the likelihood of massive failure, but also increase the likelihood (if they pay off) of returning the bank to prosperity. If the bank fails and its assets

are liquidated, the order in which stakeholders are paid off is as follows: depositors are paid first (and if the money runs out, deposit insurance makes up the residual); owners of “subordinated debt” (a kind of bond) are paid next if anything remains after paying all deposits; anything left over after satisfying the claims of depositors and holders of subordinated debt is paid out to shareholders.

- a. Explain why owners and managers of banks with very low levels of capital have an incentive to engage in such very risky behavior.
- b. Would the bank’s depositors have any incentive to withdraw their deposits as a result of the bank’s risky actions? Why?
- c. Would its shareholders be more inclined to sell their stock as a result of the risky undertakings? Why?
- d. What about the owners of subordinated debt? Why?
- e. If you were an imperfectly informed regulator who thought that market participants might have useful information about the riskiness of the bank’s investments, which market would you watch most closely: deposits, stock, or subordinated debt? Why?

3. Evaluate each step of the following argument:

- a. When world oil prices rise significantly, the “core” price level in the United States is bound to increase, because all industries use oil products and therefore will experience higher costs.
- b. However, as long as oil prices do not continue to *increase* indefinitely, this increase in core inflation is merely a one-time price-level adjustment, not an ongoing threat of high inflation.
- c. The only way to keep the core price level stable in the face of rising oil prices is for non-oil prices (and cost elements such as wages) to decline in an offsetting manner.
- d. It is far better for monetary policy to accommodate this one-time rise in oil costs than to risk triggering a recession by forcing a deflation in the prices of non-oil goods and services.
- e. Based on your evaluations above, how should the Fed respond to large increases in oil prices?

4. Use (and cite) appropriate arguments from the class readings to assess the validity of *any five* of the following seven propositions. Each answer should be no more than one-half (single-space equivalent) page in length.

- a. International factors contributed greatly to the depth of the Great Depression.
- b. Greater income inequality is a detriment to the development of democracy.
- c. High elasticity of labor supply of high-productivity workers with respect to their after-tax earnings will limit the propensity of low-productivity workers to vote for confiscatory tax rates.
- d. Contractionary monetary policy has an immediate effect on real output, but lowers inflation more slowly.
- e. Recession need not accompany disinflation.
- f. Tax cuts do not stimulate private spending, especially if they are temporary.
- g. Establishing an independent central bank is likely to lower inflation.