INSTRUCTIONS:

1. Answer ONLY the specified number of questions from the options provided in each section. Do not answer more than the required number of questions. Each section takes one hour.

2. Your answers must be on the paper provided. No more than one answer per page. Do not answer two questions on the same sheet of paper.

3. If you use more than one sheet of paper for a question, write "Page 1 of 2" and "Page 2 of 2."

4. Write ONLY on one side of each sheet. Use only pen. Answers in pencil will be disqualified.

5. Write ----- **END** ---- at the end of each answer.

6. Write your exam identification number in the upper right-hand corner of each sheet of paper.

7. Write the question number in the upper right-hand corner of each sheet of paper.

Section 2: Macroeconomics, Monetary Theory, and Econometrics—Answer One Question.

2A. (Econ 235) Draw a Bailey (or monetary Laffer) curve, clearly labeling both axes and the maximum rate of real seigniorage that a government can generate *in the long-run*. What are the diagram's simplifying assumptions? Now *provide a detailed explanation in words* (**a**) of the shape of the curve and (**b**) why the point you indicated is indeed the maximum. Your explanation should involve the demand for money and real cash balances. Then illustrate on the graph how hyperinflation might get started, again *explaining in words* the process you are depicting. Your verbal explanations must be clear, complete, and precise.

2B. (Econ 203) An enterprising applied econometrician would like to find out how to get wealthy. To accomplish this, he collects a large cross-section of data from the 2010 CPS and estimates the following regression:

$$Wealth_i = \alpha_0 + \alpha_1 educ_i + \alpha_2 male_i + \alpha_3 age_i + \alpha_4 year\ of\ birth_i + \alpha_5 married_i + \epsilon_i$$

a. This equation has a misspecification error that prevents the applied econometrician from estimating the model. Describe the problem and suggest a possible solution.
b. After solving that issue, can our applied econometrician then interpret α_1 as the causal effect of education on wealth? Why or why not?

2C. (Econ 202) Answer all of the following parts completely. Be specific.

1. Draw a *dynamic* aggregate demand-aggregate supply diagram correctly identifying both axes and all the curves.

2. What explains the slope of the aggregate demand curve?

3. Identify what can cause shifts in the aggregate demand curve. What factor do monetarists emphasize? What factor do Keynesians emphasize?

4. How would the pre-Keynesian neoclassical economists have drawn the aggregate supply curve? (You may describe it or draw it on a separate graph.) Explain why they would have drawn the curve this way.

5. How would your traditional Keynesians have drawn the aggregate supply curve? (Again, you may describe it or draw it on a separate graph.) Explain why.

6. Explain how the modern view compares with the pre-Keynesian and Keynesian views of aggregate supply. Then show on a diagram how a negative shock to aggregate demand would affect the curves in both the short-run and long run.

7. Now use the aggregate demand-aggregate supply model to portray the monetarist view of stagflation (i.e., inflationary recessions).

8. Finally, use the aggregate demand-aggregate supply model to portray what causes a recession according to real business cycle theory.

9. What theory of expectations does real business cycle theory depend upon?

(over)