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 202) Consider the economics of the national debt. Describe the two distinct ways that government may finance a deficit and discuss the economic impact of each. Make sure your answer *defines and discusses* the concepts of "monetizing the debt," "crowding out," and "Ricardian Equivalence." How do Keynesians and monetarists differ in their views about crowding out? Finally, identify and state the significance of "unfunded liabilities" and give an example.

2B. (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.

(over)

2C. (Econ 203) Consider the following linear and log-linear SRF's for the demand for beer:

Variable Name	**Definition**	**Mean**
q	liters of beer consumed	56.11
pb	price of beer ($)	3.08
pl	price of other liquor ($)	8.37
pr	price of remaining goods (an index)	1.25
i	income ($)	32,601
ehatsq	squared OLS residuals	

Results

Demand for Beer Estimates

Dep. Var.	(1) OLS-Linear q	(2) OLS Log-Linear log(q)	(3) OLS Square Residuals ehatsq
pb	-23.74*** (-4.37)		19.49 (0.68)
pl	-4.077 (-1.05)		-13.04 (-0.63)
pr	12.92** (3.10)		27.31 (1.23)
i	0.00199* (2.57)		-0.00162 (-0.39)
lnpb		-1.020*** (-4.27)	
lnpl		-0.583 (-1.04)	
lnpr		0.210* (2.63)	
lni		0.923* (2.22)	
_cons	82.16*** (4.57)	-3.243 (-0.87)	78.27 (0.82)

2C (continued):

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--------------------------------------------------------------------------
N               30              30              30
R-sq            0.822           0.825           0.081
adj. R-sq       0.794           0.797           -0.066
F               28.89           29.54           0.548
--------------------------------------------------------------------------
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t statistics in parentheses
* $p<0.05$, ** $p<0.01$, *** $p<0.001$

      a. How would you interpret the impact on beer consumption from a 50-cent increase in the price of beer and a \$1000 increase in income from the linear functional form?

      b. How would you interpret the impact on beer consumption from a one-percent increase in the price of beer and income from the log linear model?

      c. Based on the log linear model how would you describe the following: demand price; elastic or inelastic, income; normal or inferior, other liquor; substitute or complement?

      d. Discuss the pro and con of the linear and log linear form in terms of slopes and elasticities.

      e. What would you conclude about the regression of the squared residuals? Which tests would be important in interpreting the residual regression results? Which variable(s) might be of concern?