Name: _____ Student id: _____

College of Business Administration
Department of Economics
Aggregate Economic Conditions & Analysis
Lecturer: O. Mikhail
ECO 6206-0001
Spring 2001

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Mid-Term Exam

- This closed book exam is worth 100 points.
- Questions I and III are worth 30 points each.
  Questions II and IV are worth 20 points each.
  Allocate your time accordingly.
- Including the cover page, the exam totals 6 pages.
- Answer all questions.
- You are allowed an 8.5 x 11" sheet for derivatives rules only.
- Non-Programmable calculators and language dictionaries are allowed.
- DO NOT forget to write your name, your student id on the exam booklet.

6:00 p.m. – 8:00 p.m.

Exam moved from BA 121 to BA 212

February 28, 2001

Question I (20 points):

Suppose the production function has the form: $y = A.\sqrt{l} + B$ where y is output, l is labor input, A is a positive constant, and B is another constant, which maybe positive, negative, or zero.

a) Describe the wealth and substitution effects from an increase in the coefficient A. (answer using a graph).

b) Describe the wealth and substitution effects from an increase in the coefficient B. (answer using a graph).

c) What are the effects on household's work effort *l*, output y, and consumption c, from an increase in the coefficient A?

d) What are the effects on household's work effort *l*, output y, and consumption c, from an increase in the coefficient B?

Question II: (30 points) True, False or Uncertain. Explain your answer.

a) Following an optimal decision by the consumer, the marginal propensity to consume could be greater than one.

b) Empirical evidence suggests that the nominal demand for money rises more than proportionally when the price level increases.

c) The term 'real money' means things such as coins and currency rather than assets such as checking accounts that are not really money.

d) There is positive real balance effect whenever a person's initial real cash increases by the same amount as the average amount he or she plans to hold in the future.

True/False Continue:

e) An unexpected increase in future wages relative to current wages will increase current leisure relative to future leisure.

Question III: (20 points)

If yearly real consumption equals $ 18,000 and the interval between exchanges of interest-bearing assets and money is 1/12 year. Compute the,

a) Initial amount of money withdrawn.

b) Average amount of money held.

Question IV: (30 points)

Consider the Robinson Crusoe (RC) economy. There is a single good (coconuts) which can be produced with labor. RC's production function is

$$y = f(n) = \alpha + \beta n^{\gamma}$$

where n denotes labor and y denotes output. α and β are positive constant and γ is a parameter with a value in the open interval (0,1).

RC's preferences over leisure (l) and the consumption of coconuts (c) are presented by the utility function

$$U(c,l) = c^{\delta} l$$

where δ is a positive constant in (0,1).
Finally, RC has a limited amount of time per period, normalized to 1, so that

$$n + l = 1$$

a) What is the economic interpretation of α and β? Graph the production function in (y,n) space. Does this production display a falling marginal product of labor? How is it affected by the value of γ?
b) Give an expression for the marginal rate of substitution (MRS) between consumption and leisure. Are RC's preferences over c and l convex? What is the meaning of δ? Explain the intuition of why changes in δ affect the MRS.