



College of Business Administration
Department of Economics
Aggregate Economic Conditions & Analysis
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Assignment VI

Question I

True, False or Uncertain. Explain your answer.

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

False, the term refers to the amount of money measured in terms of goods, or in commodity units.

- b) 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.

False, this is the case where the real balance effect is absent.

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

False, there is emphasis is on 'Unexpected'. If it is unexpected, then no decision should be made today.

- d) Changes in the real wage can have large aggregate wealth effects.

False, consider the case of a permanent, parallel upward shift in the production function. L declines even as real output rises.

Question II

Explain why economic development tends to raise the real wage.

Economic development is a continuing series of permanent upward shifts in the production function. If the shifts are proportional, the model demonstrates that this will raise the real wage rate. If the shifts are parallel, the real wage rate also increases. A parallel, permanent shift creates a (large) reduction in the supply of labor and does not affect the demand for labor. Thus, the real wage rises.