Econ 102
Midterm Exam

Note: Total time - 50 minutes

Answer both Part A and Part B

Part A and Part B are of equal value

USE TWO EXAM BOOKS, ONE FOR PART A AND THE OTHER FOR PART B.
ON EACH EXAM BOOK PRINT YOUR NAME AND YOUR TA’S NAME.

PART A (25 MINUTES)

Justify, qualify, or repudiate EACH of the following. Be brief.

(1) Removal of the floor price for wheat will necessarily raise the price of wheat.

(2) Only when national income (Y) is in equilibrium does saving equal investment.

(3) If an economy could produce only one good, that economy would not have a Production Possibilities Frontier (PPF).

(4) “Either we are brave enough to limit our numbers [that is, total world population], or nature will impose its limits on our numbers”. (From Handout #1.)
PART B (25 MINUTES)

The island of Blitzerland has no exports and no imports. Consumer always spend $40 billion plus 50% of after-tax income, or if

\[
C = \text{consumption spending} \\
Y = \text{national income} \\
TX = \text{taxes},
\]

then

\[
C = 40 + 0.5 \times (Y - TX).
\]

Taxes are $100 billion and government spending is $150 billion, or

\[
G = 150 \\
TX = 100.
\]

Investors always want to spend $160 billion, or

\[
I = \bar{I} = 160.
\]

SHOW ALL YOUR WORK

(1) What is the equilibrium level of national income?

(2) A hurricane strikes the island, so government spending is increased by $50 billion for hurricane relief.

(a) What will be the new equilibrium level of income?

(b) If no inflationary pressures result from this increased spending, what are the two conditions that must be present in Blitzerland’s economy?

(3) Investors become extremely pessimistic because of the extensive damage done by the hurricane. Consequently, every manager of every firm that experiences any reduction in inventories will not make any attempt to rebuild those inventories; that is, the new lower level of inventories becomes the “planned” or “desired” level.

(a) Now when the government spends $50 billion on hurricane relief, what is the resulting new equilibrium level of income?

(b) At this income level (your answer to 3(a)), by how much will the level of “planned” or “desired” inventories have changed?