Universität Bern | SS 1999
Monetary Theory an Policy II | Prof. Dr. Harris Dellas

Review Questions: Section 2

1. Sometimes estimated Phillips curves are found to have a positive slope. How can one account for this?

2. Suppose that government expenditure substitutes one to one for private consumption but it does not affect production at all. What is the optimal level of government expenditure?

3. Artificial real business cycle economies exhibit much smaller consumption volatility than actual economies. Which feature of the model is responsible for this property?

4. Real business cycle models generate strongly procyclical productivity (real wage) and also significant positive correlation between hours worked and productivity. Which feature of the model is responsible for this pattern? How can it be improved?

5. What are the main policy implications of the real business cycle model? Can economic policy induce (or prevent) output-employment fluctuations in this model?

6. Why is investment significantly more cyclically volatile than consumption?

7. What set of facts would you utilize to defend the relevance of the RBC model? How does the RBC model account for the observed correlations between money and real variables?

8. Estimated Solow-Prescott residuals (the residuals from a Cobb-Douglas production function) are fairly volatile. Opponents of the RBC model argue that the behaviour of actual technology is smooth and hence the Solow residual cannot be approximating technological innovation. What else -besides technological innovation- could be captured by those residuals?

9. Suppose that half of the capital stock in the country is destroyed by a fire. How does this affect the demand and supply of labour, the real wage, the real interest rate, output and the general price level? What would your answer be if the fire burned exactly half of everyone's money without affecting anything else?

10. Can inflationary expectations cause sustained high inflation?

11. Evaluate the bank lending channel of the transmission of monetary policy.

12. Do you have an explanation for the fact that small firms are more sensitive to changes in monetary policy than large firms?

13. Does the coordination failure model with production externalities require increasing returns to scale?

14. If HD runs a counterfeiting operation in his basement and spends the new money he prints up on football equipment and on season tickets to football matches then he is better off (assuming he does not get caught). Is anyone worse off? Who and how much worse off? Assume that it is impossible to distinguish the counterfeit money from "real" money.