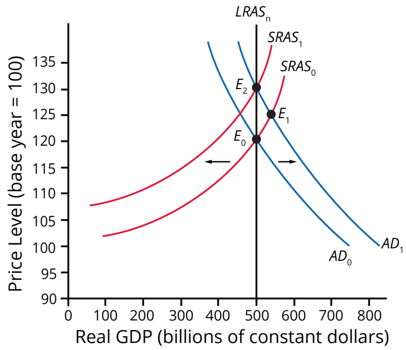
Chapter 27 Exercises

Self-Check Questions

1. Do rational expectations tend to look back at past experience while adaptive expectations look ahead to the future? Explain your answer.

2. Suppose new legislation proposes that the government should use macroeconomic policy to achieve an unemployment rate of 0% by increasing aggregate demand for as much and as long as necessary to accomplish this goal. From a neoclassical perspective, how will this policy affect output and the price level in the short run and in the long run? Sketch an aggregate demand/aggregate supply diagram to illustrate your answer. (*Hint*: examine the following figure that appeared earlier in this chapter.)



3. Would it make sense to argue that rational expectations economics is an extreme version of neoclassical economics? Explain.

4. Summarize the Keynesian and neoclassical models.

Review Questions

5. Does neoclassical economics focus on the long term or the short term? Explain your answer.

6. Does neoclassical economics view prices and wages as sticky or flexible? Why?

7. What shape is the long-run aggregate supply curve? Why does it have this shape?

8. What is the difference between rational expectations and adaptive expectations?

9. A neoclassical economist and a Keynesian economist are studying the economy of Vineland. It appears that Vineland is beginning to experience a mild recession with a decrease in aggregate demand. Which economist will likely advocate that the government of Vineland take active measures to reverse this decline in aggregate demand? Why?

10. Do neoclassical economists tend to focus more on long-term economic growth or on recessions? Explain briefly.

11. Do neoclassical economists tend to focus more on cyclical unemployment or on inflation? Explain briefly.

12. Do neoclassical economists see value in tolerating a little more inflation if it brings additional economic output? Explain your answer.

13. If aggregate supply is vertical, what role does aggregate demand play in determining output? In determining the price level?

14. What is the shape of the neoclassical long-run Phillips curve? What assumptions are made that lead to this shape?

15. When the economy is experiencing a recession, would a neoclassical economist argue for aggressive policy to stimulate aggregate demand and return the economy to full employment? Explain your answer.

16. If the economy is suffering through a rampant inflationary period, would a Keynesian economist advocate for stabilization policy that involves higher taxes and higher interest rates? Explain your answer.

Critical Thinking Questions

17. If most people have rational expectations, how long will recessions last?

18. Explain why the neoclassical economists believe that nothing much needs to be done about unemployment. Do you agree or disagree? Explain.

19. The American Recovery and Reinvestment Act was criticized by economists of all perspectives. The stimulus package was arguably a Keynesian measure, so why would a Keynesian economist be critical? Why would neoclassical economists be critical?

20. Is it a logical contradiction to be a neoclassical Keynesian? Explain.

Problems

21. Use the table to answer the following questions.

Price Level	Aggregate Supply	Aggregate Demand
90	3,000	3,500
95	3,000	3,000
100	3,000	2,500
105	3,000	2,200
110	3,000	2,100

a. Sketch an aggregate supply and aggregate demand diagram.

b. What is the equilibrium output and price level?

c. If aggregate demand shifts right, what is the equilibrium output?

d. If aggregate demand shifts left, what is the equilibrium output?

e. In this scenario, would you suggest using aggregate demand to alter the level of output or to control any inflationary increases in the price level?