14.02 Principles of Macroeconomics
Professor Roger Brinner
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Problem Set 6 Questions
Posted May 2, 2002
Due May 9, 2002

50 Points, 5 points for each question (Parts I-II) or sub-part (Part III)

NOTE TO GRADERS: ITALICIZED PORTIONS OF ANSWERS ARE NOT REQUIRED, THEY ARE FOR ELUCIDATION ONLY!

Part I. True/False Questions.

Answer "true" or "false", and justify your answer with a short argument.
(Points are awarded based on the *explanation only*.)

1. When bond prices increase, interest rates increase.

2. The change in a country's debt to GDP ratio depends (in part) on the relative magnitudes of its real interest rate and its growth rate of output.

3. Public debt-to-GDP ratios that are "too high" can raise interest rates.

4. Contractionary fiscal policy must decrease output in the short-run. (Hint: consider the role of expectations.)

5. A central bank should not consider targeting zero inflation, since inflation is simply a nominal phenomenon and does not change the real price of anything
(Hint: see, e.g., the summary at the end of Chapter 26.)

6. The obvious solution to reforming Social Security in the United States is to switch from a pay-as-you-go system to a fully funded system based on private saving, effective immediately.

II. Multiple Choice (select one answer, and explain)

1. Which was NOT a main ingredient of the Thailand financial crisis?
(Hint: see Prof. Brinner's lecture notes)
a. Devaluation of Chinese currency
b. Appreciation of US currency
c. Huge, growing current account deficits
d. Poor institutions for regulating financial markets
e. Declining secondary education rates

2. Which is NOT a *potential* source of convergence in output *per capita* between poorer and richer countries?
(Hint: See Prof. Brinner's lecture notes on financial crises, and Blanchard p. 239)
a. Technology transfer
b. International markets for human capital
c. Population growth
d. Capital Accumulation
e. neither c. nor d.

III. Short Answer

a. Why would a developing country choose a "hard peg" to (i.e., a fixed exchange rate with) the dollar?
(Hint: think about what type of credibility this provides, and the resulting benefits.)

b. What are the main problems with a "hard peg"?