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Macro Theory

Problem Set #2

1a. Determine the values of L, Y, W and P from the following Neo-Classical Model (a variant of Model 1).

(1)	$L = 200 - 5*(W/P)$	Labor Demand
(2)	$LS = 100 + 10*(W/P)$	Labor Supply
(3)	$L = LS$	Labor Market Equilibrium
(4)	$Y = 100*L^{.75}$	Production Function
(5)	$4*M = P*AD$	Quantity Theory of Aggregate Demand
(6)	$Y = AD$	Goods Market Equilibrium

Assume M = 500 (the only exogenous variable)

b. What are the effects on the variables computed in a. if the stock of money is doubled?

2. In what ways are instability and unemployment explained by the Neo-Classical model? What policies would neo-classicists suggest to alleviate such problems?

3a. How would the labor market equilibrate in the Neo-Classical model? What forces can change the character of the stopping point in the labor market? How are these forces related to the level of output (in Model 1)?

b. What equilibrates the money market in the Neo-Classical model? How are money, credit, and goods markets related in Model 1?

4. Use Model 1 to answer the following questions.

a. Assume that raw materials and labor are substitutes. How does an increase in raw materials affect the price level, the employment level, the real wage and output?

b. How does a decline in investment expenditure affect the variables noted in a?

5. Consider the following information about behavior and technology in Classicstown.

A. Labor Demand $L = 1000 - 5*(W/P)$
B. Labor Supply $LS = 800 + 15*(W/P)$
C. Production $Y = 500*L^{.5}*K^{.5}$
D. Consumption $C = 200 + .8*Y$
E. Money Demand $Md = 20*P*Y$

a. Add whatever equations are needed to complete this model of Classicstown; assume all markets are in competitive equilibrium.

b. Derive the aggregate supply curve.

c. Compute the equilibrium values for Y, W/P, L and I assuming K=100 and M=20,000.

6. Do problems 3 and 6 (on page 100) of Chapter 4 in Mankiw (8^{th} edition).