# *ECONOMICS 113 — MIDTERM EXAMINATION #2*

PART I.   Short Questions (20 points total; 14 minutes total) Keep your answers brief and focused.  Each question is worth just 5 points.  **Answer all four questions.**

1.        (5 points) What is the message conveyed by this table?

| Table:  Sources of Drop in Real GNP | | | | | |
|---|---|---|---|---|---|
| | | Share of Drop in GNP Due to: | | | |
| | % Δ Real GNP | Consumption | Inventory Investment | Fixed Investment | Net Exports | Government Purchases |
| 1921 | -2.4 | -195 | 256 | 51 | 43 | -56 |
| 1930 | -9.3 | 46 | 24 | 38 | 2 | -10 |
| 1931 | -6.2 | 38 | 3 | 62 | 6 | -9 |
| 1932 | -15.8 | 50 | 20 | 26 | 1 | 4 |
| 1933 | -3.0 | 66 | 4 | 19 | 9 | 3 |
| 1938 | -5.5 | 22 | 94 | 38 | -26 | -28 |
| Source: Romer, "The Nation in Depression," *JEP* (Spring 1993): Table 2. | | | | | | |

2.        (5 points) What is the likely historical relevance of this 1920s image?
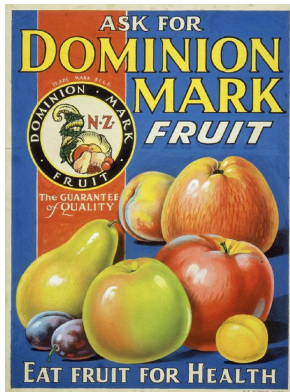


3.        (5 points) List the immigration restrictions imposed in the 1920s.  Be specific for full credit.

4.        (5 points) What does this table tell us about the use of expansionary fiscal policy in the 1930s?  Briefly explain.

**Table:  Net Shift in Full-Employment Demand
As a Percent of Full-Employment GNP**

|  | Federal | State & Local | Total |
|---|---|---|---|
| 1929 | -0.4 | 1.8 | 1.4 |
| 1930 | 0.0 | 2.0 | 1.9 |
| 1931 | 1.7 | 1.8 | 3.6 |
| 1932 | 1.0 | 0.9 | 1.8 |
| 1933 | 0.5 | 0.1 | 0.5 |
| 1934 | 2.0 | -0.4 | 1.5 |
| 1935 | 1.9 | -0.3 | 1.6 |
| 1936 | 2.5 | 0.2 | 2.7 |
| 1937 | 0.1 | 0.1 | 0.2 |
| 1938 | 1.2 | 0.0 | 1.2 |
| 1939 | 1.4 | 0.5 | 2.0 |

Source: E. Cary Brown, "Fiscal Policy in the 'Thirties: A Reappraisal," *American Economic Review* (Dec. 1956): 864-865.

Part II. Using Economic Models and Concepts to Explain Historical Events (36 points total; 25 minutes total) **Answer all three questions.**

1. (12 points) Use the concept of the life-cycle hypothesis (LCH) to explain Prof. Sutch's argument about homeownership rates among immigrants around 1900.

2. (12 points) Use the concepts of illiquidity and insolvency to explain why the Fed acting as a "lender of last resort" could have prevented some bank failures but not others.

3. (12 points) Use the two graphs below to explain why Prof. Romer concludes that monetary policy after 1933 explains the relatively rapid growth of output 1933-1937.
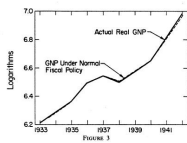


ACTUAL OUTPUT AND OUTPUT UNDER NORMAL FISCAL POLICY, 1933–1942
*Note:* The dashed line shows the path of the log-value of real GNP under the assumption that fiscal policy was at its normal level throughout the mid- and late 1930s; the solid line shows the path of actual real GNP.
*Source:* The calculation of output under normal fiscal policy is described in the text. The source for real GNP is the same as in Figure 1.
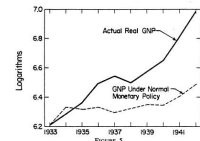


ACTUAL OUTPUT AND OUTPUT UNDER NORMAL MONETARY POLICY, 1933–1942
*Note:* The dashed line shows the path of real GNP under the assumption that the money growth rate was held to its normal pre–Depression level throughout the mid- and late 1930s; the solid line shows the path of actual real GNP.
*Source:* The calculation of output under normal monetary policy is described in the text. The source for real GNP is the same as in Figure 1.

Choose **two** of the following **three** pairs of items. First, in your mind, figure out the economic concept that connects the two terms. Then, on your exam, define or identify or describe each term in the pair (6 points), providing enough detail to support the connection between the terms. Then, finally, discuss the connection between the two terms (4 points). Each answer is worth 10 points total. You should spend about 7 minutes on each question.

1. (10 points)
a. Olney's explanation for why white but not black families could get merchant credit in the 1920s
b. Bernanke's explanation for why bank failures led to investment decline in the early 1930s

2. (10 points)
a. Public financing of railroad construction after the Civil War
b. Public financing of higher education in the early 20th century

3. (10 points)
a. Frederic Mishkin's argument re: why consumption spending fell in the Great Depression
b. Christina Romer's argument re: why consumption spending fell in the Great Depression


Part IV. Short Essay Question (24 points total; 18 minutes total)
Answer **one** of the following **two** questions. (The questions are similar but are focused on different articles. And yes, it's the same question as you had on midterm #1. That's because this question provides a decent approach for your term paper.) Base your answers on lecture, discussion section, **and** the assigned reading. *Complete answers will draw from all three sources.*

1. In reader article #1 ("Economic History and Economic Policy"), Barry Eichengreen discussed "analogical reasoning" – creating historical analogies to contemporary events, providing insight into and policy ideas for solving contemporary economic and social problems. The proper analogical use of history requires knowing which aspects of the historical episode are critical to the analysis of history, and which aspects are (and are not) relevant to the contemporary issue.

A. (10 points) Consider Wheelock's analysis of 1920s bank failures in Kansas (reader article #8, "Regulation and Bank Failures: New Evidence from the Agricultural Collapse of the 1920s"). What question does Wheelock address? What is his argument? What is his answer to the question?

B. (2 points) Based on your knowledge beyond Econ. 113, identify a contemporary issue or problem that Wheelock's analysis might provide insight into. "Contemporary" can be interpreted broadly as "during your lifetime." Do not provide very much detail in your answer. Simply state the issue, identifying the country and time period.

C. (12 points) What is one assumption in Wheelock's analysis that is critical to his conclusion? Is that assumption relevant to analyzing the contemporary issue you listed in part (b)? Explain (1) how the assumption you cite is critical to Wheelock's conclusion and (2) why you say the assumption is (or isn't) relevant to analyzing the contemporary issue you listed in part (b).

2. In reader article #1 ("Economic History and Economic Policy"), Barry Eichengreen discussed "analogical reasoning" – creating historical analogies to contemporary events, providing insight into and policy ideas for solving contemporary economic and social problems. The proper analogical use of history requires knowing which aspects of the historical episode are critical to the analysis of history, and which aspects

are (and are not) relevant to the contemporary issue.

A.    (10 points)  Consider Goldin & Katz's analysis of the high school movement in Iowa (reader article #9, "Human Capital and Social Capital: The Rise of Secondary Schooling in America, 1910-1940").  What question do Goldin & Katz address?  What is their argument?  What is their answer to the question?

B.    (2 points) Based on your knowledge beyond Econ. 113, identify a contemporary issue or problem that Goldin & Katz's analysis might provide insight into.  "Contemporary" can be interpreted broadly as "during your lifetime."  Do not provide very much detail in your answer.  Simply state the issue, identifying the country and time period.

C.    (12 points) What is one assumption in Goldin & Katz's analysis that is critical to their conclusion?  Is that assumption relevant to analyzing the contemporary issue you listed in part (b)?  Explain (1) how the assumption you cite is critical to Goldin & Katz's conclusion and (2) why you say the assumption is (or isn't) relevant to analyzing the contemporary issue you listed in part (b).