

Exam 1

ARE 012, Spring 1997

Answer the six (6) questions below to the best of your ability. Answer all parts of each numbered question. Use a separate sheet of paper to answer each numbered question, and arrange your answers in numerical order when finished with the exam. Write the number of the question and your name on the top of each sheet of paper you use. **You must show all work to receive full credit.** The price of all parts of each question (input) is provided so that you may make an informed management decision regarding the production of this exam (output). **DO NOT** write answers on the test sheets. Be thorough and complete in ALL your responses. **RETURN THE TEST SHEET !!!** No test sheet: **F** for the exam. Please read and sign the Honor Pledge on the test sheet below or your exam will not be graded:

I have neither given or received unauthorized aid on this exam. _____
Student's Signature

1. Please illustrate the "consumption-production model" in equilibrium, **AND** label each component of the model (5 points), then respond to items a, b, and c below.
 - a. Assume you are an executive with Ford Motor Corporation. You have been given data that shows passenger car inventories on dealers' lots are at a 63-day supply as of February 1; a 60-to-65-day supply is considered an ideal inventory level. What conclusion would you come to regarding current consumption of passenger cars relative to current production? (5 points)
 - b. Passenger car assembly plants are currently operating at 75% capacity. Production above 85% of capacity becomes increasingly expensive and quality will be adversely affected. What action, in the short run, should the "typical manager" take given this information and information provided in "a" above? (5 points)
 - c. If after the action (or no action) taken in "b" above, passenger car inventory levels on dealer lots are at a 45 day supply on March 1; explain what action you would take in detail. (5 points)

2. You are the new President of the United States. The previous Congress passed a Balanced Budget Amendment to the Constitution, the previous President signed the Amendment, and the states ratified the Amendment. You are confronted with a national economy with GDP currently expanding at a rate of -1.0%, and an unemployment rate 9.5%.
 - a. Please describe the current condition of the economy. (5 points)
 - b. Please illustrate and explain how you and Congress could use fiscal policy to correct the situation you gave described in "a" above. Remember, NO DEFICIT is allowed! The federal budget must be balanced by law. Please use the **Production-Consumption Model** to **illustrate your** answer to this question, then **explain**. (15 points)

For Example: $\downarrow \uparrow T \implies \downarrow \uparrow I_D \implies \uparrow ?? \implies \downarrow \uparrow ?? \implies ?$

3. You are the Federal Reserve Chairman. GDP is currently increasing at an annual rate of 1.5%, and unemployment is currently at 6.5%. Employers are reporting difficulty in keeping employees busy and

expect to not provide any wage increases in the coming year. Inventory levels for major manufacturing firms are beginning to increase even though manufacturing facilities are only operating at 70% of capacity. The prime interest rate is at 8.25%. The discount rate is 5.00%. Please describe the current condition of the economy. (5 points)

- a. Please illustrate and explain what Monetary Policy action you would take under these circumstances. Please use the **Production-Consumption Model** to **illustrate** an answer to this question, then **explain**. (15 points)

4. A 36 month automobile loan on a new vehicle at Nations bank is 8.93%. If the real interest rate is 2.15%, and the expected inflation rate over the life of the loan is 2.5% per year, please calculate the Nations Bank's risk premium. (5 points).

- a. If the interest rate for one year U.S. Treasury Bills is currently 5.73%, and the real interest rate is 2.15%, please calculate the expected inflation rate for the U.S. economy over the next twelve months (5 points).

- b. Farmer Moore is a very successful flue-cured tobacco farmer in Eastern N.C. His operation is very profitable and has expanded from 50 acres of flue-cured tobacco in 1976, to 150 acres of production today. Farmer Gregory is a very young, innovative tobacco farmer who graduated from the Agricultural Institute two years ago. Farmer Gregory is a much smaller tobacco farmer than Farmer Moore. Due to rising production costs, and a bad crop year this past season due to hurricane Bertha and Fran, Farmer Gregory is struggling to pay the bills. Farmer Gregory had no crop insurance on his tobacco.

You are a Farm Credit System Loan Officer. Would you offer these two gentlemen the same nominal interest rate on an operating loan for the coming growing season? (1 point) **Thoroughly explain WHY or WHY not?** (4 points)

5. Mr. Parnell's gross income is \$32,000 for the 1996 tax year. Mr. Parnell has a wonderful wife and four bright children in grade school (Yep, he was pretty busy). Mr. Parnell will be filing a joint tax return with itemized deductions totaling \$6,500. His federal income tax rate is 15%. His state income tax rate is 7.00%. Mr. Parnell must also pay 7.65% of his gross income to the Social Security and Medicare systems. Mr. Parnell spends \$23,500 per year for family living expenses (Wife, four children in grade school, mortgage payment, food, clothing, car payments, etc.). Standard Deduction = \$6,700. Value of Exemptions = \$2,550.

- a. Calculate Mr. Parnell's taxable income for 1996 (5 points)

- a. Calculate Mr. Parnell's disposable income for the year (5 points).

- b. Calculate Mr. Parnell's discretionary income for the year (5 points).

6. What are the minimum conditions required for "good" competition to develop in a capitalist economic system? (10 points)

BONUS QUESTIONS:

Answer the questions below. Each correctly answered question will add the points indicated to your raw test score.

1. List all the functions of **government** as outlined under pure capitalism (5 points)
2. What is the economic meaning of scarcity? (5 points)
3. Thoroughly explain why the government provides **“Public Goods”**? (10 points)

What “explain” means on one of my exams:

Webster’s Collegiate Dictionary defines EXPLAIN as:

1. to make plain or understandable
2. to give the reason of or cause of
3. to show the logical development or relationships of

Webster’s continues by enhancing the definition with the following statement:

"Explain implies a making plain or intelligible what is not immediately obvious or entirely known."