Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 225 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 7 minutes. Because of the class that follows yours, I cannot give extra time.

1) (12 points) Answer EITHER Part A OR Part B.
A) Our model assumes there are no taxes. If we include an income tax in our model, would the autonomous expenditure multiplier go up or down? Explain your logic.
B) Using either equation in question #4, what do you think the size of the autonomous expenditure multiplier would be for Bethany? Explain your logic.

2) (12 points) Answer EITHER Part A OR Part B.
A) What is meant by *elasticity pessimism*? What caused it?
B) What is the economic reason that the supply curve of a currency may slope up or down?

3) (16 points) Answer EITHER Part A OR Part B.
A) Draw the Swan diagram and place a point where there is an internal balance, but a current account deficit. Explain how you know there is a current account deficit.
B) Does the line signifying an internal balance on the Swan diagram slope up or down? Explain your logic.

4) (16 points) Answer EITHER Part A OR Part B.

A) The book says $k* = \dfrac{\Delta Y_1}{\Delta I_1} = \dfrac{1 + MPM_2 / MPS_2}{MPS_1 + MPM_1 + MPM_2(MPS_1 / MPS_2)}$. Explain the

economic reasons why an increase in MPM_2 can cause both an increase and a decrease in the autonomous expenditure multiplier for Country #1.

B) The book says $k** = \dfrac{\Delta Y_1}{\Delta I_2} = \dfrac{MPM_2 / MPS_2}{MPS_1 + MPM_1 + MPM_2(MPS_1 / MPS_2)}$. Explain why there

is no "1" in the numerator as in part A. Explain why an increase in the MPM_1 would cause the autonomous expenditure multiplier for Country #1 to decrease.

5) (24 points) Illustrate on the IS/LM/BP diagram EITHER the event in Part A OR the event in Part B.
A) The currency devalues.
B) The price level increases.

6) (30 points broken down as described below) Do EITHER Parts A1 - A4 OR Parts B1 - B2.
A) Use the graph on the back to answer ALL sections of Part A. The green crosses are the demand for the good, the yellow squares are the supply of the good with one exchange rate and the red triangles are the supply of the good with the other exchange rate. The other currency is the Japanese yen (¥).
   A1) (6 points) Is this diagram showing the Japanese demand for US exports or US demand for Japanese exports? How can you tell?
   A2) (6 points) **Given your answer in part A**, can you find two points on the supply of US$, the demand for US$, demand for ¥, or supply for ¥? How can you tell?
   A3) (6 points) If one demand line corresponds to an exchange rate of US$0.01/¥ and the other demand line corresponds to an exchange rate of US$0.02/¥, which line corresponds to which exchange rate? How can you tell?

A4) (12 points) Derive two points on either the supply or the demand for ¥. Show all work and briefly explain what you did.

B) Do both sections B1 and B2.

B1) (16 points) Draw the J-curve and use the Marshal-Lerner condition to explain why it takes that shape.

B2) (14 points) Draw the supply and demand for Sri Lankan Rupees (Rs.) that has an unstable. equilibrium. Explain why it is unstable.

7) (40 points) Illustrate on BOTH the 45° diagram, a.k.a. Keynesian cross diagram, AND the IS/LM/BP diagram, EITHER the event in Part A OR the event in Part B. Explain why the curve(s) moved as drawn. Suse the same event for both diagrams.

A) The marginal propensity to save increases.

B) The money supply increases.