

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 100 points (to be scaled up to 160 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I cannot give extra time because some students have a class after your class.

1) (10 points) Answer ONE of the three parts.

- A) We said that the $C+I+G+X$ line is similar to the AD line. Explain why they are virtually the same.
- B) We said the LRAS curve moves whenever the PPF (a.k.a. PPC) moves. Why is that?
- C) We said that if the LRAS curve moves then the SRAS curve must also move. Why is this true? (Note the converse is not true.)

2) (10 points) Answer EITHER Part A OR Part B.

- A) Next Monday, the world population will reach 7,000,000,000. (There were only 5.4 billion people when you were born.) At the current rates, the world population will double by 2078. What do these statistics say about the economic development of most of the world? Explain your logic.
- B) What is *creative destruction*? How does it help a country to have economic development?

3) (12 points) For EITHER the LRAS curve OR the AD curve, draw the line and explain why it takes its shape.

4) (18 points) Answer EITHER Part A OR Part B.

- A) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to GDP and price level?
- B) Draw the Keynesian Cross, a.k.a. 45° diagram. Illustrate the effects of an increase in the income tax. Explain why the curve(s) moved as drawn. What happens to GDP and price level?

5) (18 points) Answer EITHER Part A OR Part B.

- A) Draw the SRAS/LRAS/AD diagram for an economy in an inflationary gap. Show the inflationary gap. Explain how you found it. What will happen if the economy is left alone? Illustrate that event on the graph and explain why the line(s) moved as drawn.
- B) The review sheet says a sales tax has a different effect upon the LRAS/SRAS/AD diagram than an income tax. (Hint: The effect is just like effect of a sales tax in microeconomics.) Illustrate the effect of an increase in the sales tax on the LRAS/SRAS/AD diagram. Explain why the curve(s) moved as drawn. What happens to the price level and GDP?

6) (32 points) Answer EITHER Part A OR Part B.

- A) Illustrate an increase in interest rates on the SRAS/LRAS/AD diagram and the Keynesian Cross, a.k.a. 45° diagram. Explain why the curve(s) moved as drawn. What happens to GDP and the price level?
- B) Illustrate an increase in marginal propensity to save on the SRAS/LRAS/AD diagram and the Keynesian Cross, a.k.a. 45° diagram. Explain why the curve(s) moved as drawn. What happens to GDP and the price level?