

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 EITHER Part A OR Part B.

A) Why should $S = I$? Make sure you define what both variables are.

B) Define *cost-push inflation*. Give an example of it and briefly explain why that fits the definition.

2) (10 points) Draw EITHER the Keynesian SRAS OR the AD curve and explain why it takes its shape.

3) (12 points) Answer EITHER Part A OR Part B.

A) The government debt is huge as is the government deficit. Why is it difficult to eliminate the deficit? Make sure you mention the two general ways to cut it and why those are difficult to do.

B) Politicians give many reasons why the debt is a big problem. Some are valid and others are not. What do you consider to be the weakest argument about why the debt is bad? Explain why that argument is weak.

4) (12 points) We said that *lags* and *Ricardian Equivalence* can cause problems for countercyclical fiscal policy. For EITHER *lags* OR *Ricardian Equivalence*, explain why it might make countercyclical fiscal policy either less effective or possibly counterproductive.

5) (16 points) Answer EITHER Part A OR Part B.

A) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an improvement in technology. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

B) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in the Canadian Economy. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

6) (20 points) Answer EITHER Part A OR Part B.

A) Draw an SRAS/LRAS/AD diagram for an economy in an **inflationary gap**. State how you know there is an inflationary gap. What type of fiscal policy should be done in this situation? Explain why the curve(s) moved as drawn.

B) Draw an SRAS/LRAS/AD diagram for an economy in a **recessionary gap**. State how you know there is a recessionary gap. If the government did nothing, how would the economy correct itself. Explain why that occurs. Illustrate the effects on the diagram. Explain why the curve(s) moved as drawn.

7) (20 points) Answer EITHER Part A OR Part B.

A) Suppose the government spending was \$1000, transfer payments are $\$950 - .05 \cdot \text{GDP}$, and tax revenue is $.15 \cdot \text{GDP}$. If GDP is \$10,000 then how much is the government deficit or surplus. If Y_{FE} is \$9,000 then how much is the full-employment deficit? Show all work. Is the government doing good fiscal policy? Explain your logic.

B) Explain the differences between the *net public debt*, *gross public debt*, and the debt which Paul O'Neill talked about. Which do you think is the more relevant one when we are discussing the problem of crowding out? Explain your logic.