

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. I will not grade what is written on this sheet.

1) (12 points) Answer EITHER Part A OR Part B.

A) Suppose a person's consumption function is given by $C = 2000 + .8(Y-T)$. Their disposable income is \$20,000. How much are their MPC, MPS, APC, and APS? Show all work. If there is no work, then briefly state how you got the number.

B) The LRAS line is very similar to another line we studied this semester. Which graph was that and explain why they are virtually the same. (It is not S.)

2) (12 points) Answer EITHER Part A OR Part B.

A) Why is saving so important for the growth of GDP? Explain your logic.

B) What are the two reasons why you should start saving now for retirement? Explain your logic.

3) (12 points) For EITHER the term in Part A OR the term in Part B, explain what the term means and explain how that helps a country's economy to grow faster.

A) Creative destruction

B) Enforcing property rights.

4) (12 points) How does economic growth lead to ONE of the following? Explain your logic and put your answers in separate paragraphs.

A) Breakdown of the family

B) Longer lives

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

A) Draw the Keynesian Cross diagram, a.k.a. 45° diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, what is the size of the government spending multiplier. Explain how you reached that conclusion.

B) When we estimated the government spending multiplier, we initially came up with the number 10. What does that number mean? We made an assumption about interest rates. What did we assume? If we relaxed that assumption (i.e., no longer assume that), what would happen to the size of the multiplier? Explain your logic.

6) (34 points) Draw EITHER the event in Part A OR the event in Part B on the SRAS/LRAS/AD diagram and on the Keynesian Cross diagram, a.k.a. 45° diagram. Do the SAME EVENT for both graphs.

Explain why the curves moved as drawn. What happens to GDP and the price level?

A) The income tax increases

B) The marginal propensity to save increases.