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 150
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 can give some extra time, but not much.

1) (10 points) Answer ONE of the following parts.
A) When we drew the NS curve upward sloping, which effect did we assume is larger? Explain your logic.
B) All statistics have problems with their definition which makes them less useful than we would like.
What are two problems with the unemployment rate? Briefly explain what causes that problem.
C) All statistics have problems with their definition which makes them less useful than we would like.
What are two problems with the inflation rate? Briefly explain what causes that problem.

2) (10 points) Answer EITHER Part A OR Part B.
A) Explain $r = (i-\pi^e)/(1+\pi^e)$ including why π^e appears twice
B) Explain $S_{GVT} = (T - TR - INT) - G$

3) (12 points) Answer EITHER Part A OR Part B.
A) We said the velocity of money may be a function of another variable. What is that variable? Explain
how it may affect V.
B) What is the neutrality of money? Without using any graph, explain why it might hold.

4) (16 points) Answer EITHER Part A OR Part B.
A) Draw the MPK^F/uc_K diagram. Illustrate the effects of an increase in the corporate tax rate. Explain why
the curve(s) moved as drawn. What happened to the user cost of capital and the desired amount of capital?
B) Use the MPK^F/uc_K diagram to explain why an increase in the depreciation rate will have an ambiguous
effect on investment.

5) (16 points) Answer EITHER Part A OR Part B.
A) Draw the intertemporal budget constraint. Illustrate an increase in current income. Explain why the
curve moved as drawn. What happens saving done this year? Explain your logic.
B) Use EITHER Modigliani's Life Cycle Model Graph OR Friedman's Permanent Income Hypothesis to
explain why President George W. Bush's one time tax cut for 2001 had almost no impact upon the
economy.

6) (16 points) Answer EITHER Part A OR Part B.
A) Draw the graph for the Solow Growth Model. Illustrate the effects of a decrease in the saving rate.
Explain why the curve(s) moved as drawn. What happens to the GDP per capita and the capital-labor
ratio? Briefly explain how you see both of them on the graph.
B) Write the equation for the Endogenous Growth Model. Use it to explain how the government's
subsidization of education will impact the growth rate of the economy.

7) (20 points) Answer EITHER Part A OR Part B.
A) Draw the S/I diagram for large open economy with a capital-financial account deficit. State how you
know your graph shows the deficit. Illustrate the effects of a decrease in government spending in the rest
of the world. Explain why the curve(s) moved as drawn. What happens to the level of saving and
investment?
B) For both events, determine the debit and credit. Then determine what happens to the NX, CA,
short-term KFA, long-term KFA, and the KFA. Briefly explain your logic. An American store buys
$11,000 worth of Chinese solar panels from the Chinese company. You sell a $10,000 US Treasury bond
to a Canadian.