

Write your name on the cover of the test booklet and nowhere else. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 210 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. I cannot give extra time because there are classes after yours.

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

A) Developing countries complain that using real GDP per capita as a measure of development does not work well because their GDP statistics do not reflect the production within the country. Give two reasons why this is probably true.

B) Why might the unemployment numbers be misleading? Give two reasons.
Why did I say that $r = (i - \pi^e)/(1 + \pi^e)$ rather than the book's equation of $r = i - \pi^e$?

2) (14 points) Answer EITHER Part A OR Part B.

A) Explain what aggregating is and why we do it.

B) Why do Keynesian and Classical Economists rarely agree? How can they both be correct?

3) (16 points) Bush's economic policy has multiple aspects to it. Two of them are listed below. For EITHER the aspect in Part A OR the aspect in Part B, explain the effect it will have upon investment.

A) The government is spending so much that it is borrowing and driving up interest rates.

B) The corporate tax rates are down.

4) (16 points) Illustrate EITHER the event in Part A OR the event in Part B on the savings and investment diagram. Explain why the curve(s) moved as drawn.

A) The depreciation rate increases.

B) There is an increase in the future marginal productivity of capital.

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

A) What is Ricardian Equivalence? Do you believe it? Explain your logic.

B) Explain either the *Life-Cycle Model* or the *Permanent Income Theory*. Why do durable goods cause problems for testing the accuracy of the predictions?

6) (18 points) Answer EITHER Part A OR Part B. (All numbers are in billions of US\$, so you can leave off the billions.)

A) If compensation to employees is \$4200, proprietors' income is 420, rental income of persons is 71, corporate profits are 490, net interest is 420, indirect business tax is 700, consumption of fixed capital (depreciation) is 770, factor income received from abroad is 140, and payments of factor income to the rest of the world is 70, then calculate NI, NNP, GNP, and GDP. Show all calculations and write the generic forms of the equations you used.

B) If GDP is \$7000, net factor payments from abroad are -70, consumption is 4480, government purchases are 1400, interest payments on government debt are 210, taxes are 2450, and transfers are 1050, then how much are private savings, government savings, and national savings? Show all calculations and write the generic forms of the equations you used.

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

A) Explain $c^f = (y + a - c)(1+r) + y^f$.

B) Explain BOTH $r_{a-t} = (1-t)i - \pi^e$ AND $\Delta Y/Y = 3 - 2\Delta u$. Do not worry about the values 3 and 2.

8) (36 points) Illustrate the EITHER the event in Part A OR the event in Part B on production function with labor on an axis AND on the labor supply and demand diagram. Illustrate the same event on both graphs and explain why the curve(s) moved as drawn.

A) The labor force participation rate increases.

B) There is more capital.