

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 140 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 10-point question should take 5 minutes. I cannot give extra time because some students have a class after your class.

1) (14 points) Explain the equation in EITHER Part A OR Part B.

A) $uc = (r+d)p_k$.

B) $r_{a-t} = (1-t)i - \pi^e$.

2) (16 points) Answer EITHER Part A OR Part B.

A) Draw the diagram from the Slow Growth Model. Use it to explain why Solow concludes that economies should converge to the same capital-labor ratio.

B) Why does an increase in the depreciation rate have two different effects upon investment?

3) (16 points) Answer EITHER Part A OR Part B.

A) The welfare of which part of society is measured by NI? Explain your logic by comparing it to PI and NNP.

B) What are the three ways of calculating GDP? Why should they give the same result?

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

A) Illustrate on the labor supply/labor demand diagram an increase in the income tax. Explain why the curve(s) moved as drawn. What happens to the amount of labor hired and the wage rate paid?

B) Use an appropriate diagram to show why a temporary drop in the income tax rate will have very little effect upon consumption. Explain how you used the diagram to reach the conclusion.

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

A) Draw the S/I diagram for a small open economy which has a KFA surplus. Explain how you know it is a KFA surplus. Illustrate an increase in the future marginal productivity of capital. Explain why the curve(s) moved as drawn. What happens to the interest rate, quantity of savings, and quantity of investment?

B) Draw the uc_k/MPK^f diagram. Illustrate an increase in the interest rate. Explain why the curve(s) moved as drawn. What happens to the rental rate of capital and the quantity of capital desired? What is the economic reason for this?

6) (18 points) Answer EITHER Part A OR Part B.

A) Illustrate the increase in the price of oil on the IS/LM/FE diagram. Explain why the curves moved as drawn. What happens to GDP and the interest rates?

B) Draw the LRAS/SRAS/AD diagram. Illustrate an increase in the value of the dollar on the exchange rate. Explain why the curve(s) moved as drawn. What happens to GDP and the interest rates?