

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 150 points (to be scaled up to 225 points) and is scheduled to take 75 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 EITHER Part A OR Part B.

- A) Which has a larger autonomous expenditure multiplier, an open or a closed economy? Why?
 B) How can an increase in government spending of \$100 cause GDP to go up by more than \$100?

2) (10 points) Answer EITHER Part A OR Part B.

A) The foreign trade multiplier with foreign repercussions is given by:

$$k^* = \frac{\Delta Y_1}{\Delta I_1} = \frac{1 + MPM_2 / MPS_2}{MPS_1 + MPM_1 + MPM_2 (MPS_1 / MPS_2)}$$

Explain why the MPM_2 in the numerator affects k^* in the manner it does.

B) The foreign trade multiplier with foreign repercussions for an autonomous increase in foreign investment is given by:

$$k^{**} = \frac{\Delta Y_1}{\Delta I_2} = \frac{MPM_2 / MPS_2}{MPS_1 + MPM_1 + MPM_2 (MPS_1 / MPS_2)}$$

Explain why there is no "1" in the numerator.

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

- A) Draw the J-curve. Explain why it takes its shape.
 B) State the Marshall-Lerner Condition. Use it to determine if the exchange rate should be stable in the long run. Explain your logic.

4) (16 points) Answer EITHER Part A OR Part B.

- A) Draw a supply and demand diagram for foreign currency with both curves sloping downward. You can draw either one flatter than the other - I do not care which is flatter. Given the way your lines cross, is that equilibrium a stable equilibrium? How can you tell?
 B) Explain how the identification problem can cause elasticity pessimism.

5) (18 points) Draw EITHER the event in Part A OR the event in Part B on the 45° diagram, a.k.a. Keynesian cross diagram. Explain why the curve(s) moved as drawn.

- A) The marginal propensity to import increases.
 B) The income tax rate increases.

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

- A) Draw the Swan diagram. Explain why the line which slopes up does that.
 B) Explain why both the IS and BP lines take their shapes.

7) (22 points) Answer EITHER Part A OR Part B.

A) Draw the IS/LM/BP diagram with the BP line flatter than LM line. Use it to prove that monetary policy cannot work if there is a fixed exchange rate.

B) Draw the 45° diagram, a.k.a. Keynesian cross diagram. Illustrate an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, what is the size of the autonomous expenditure multiplier? Explain your logic.

8) (40 points) Answer EITHER Part A OR Part B.

A) Draw an IS/LM/BP diagram with the BP line flatter than the LM curve. Start with all three curves crossing at one point and assume a flexible exchange rate. Draw an increase in government spending. Show the initial movement(s) and explain why the curve(s) moved as drawn. Show the movement(s) back to equilibrium. Explain why the curve(s) moved as drawn.

B) Draw an IS/LM/BP diagram with the LM line flatter than the BP curve. Start with all three curves crossing at one point and assume a flexible exchange rate. Draw an increase in the tax rate. Show the initial movement(s) and explain why the curve(s) moved as drawn. Show the movement(s) back to equilibrium. Explain why the curve(s) moved as drawn.

9) (-30 points) What is my lucky number? (This question is an April Fool's joke, but the rest of the exam is not.)