

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

The aggregate supply and demand diagram gives some counter-intuitive results if you do not use the short-run aggregate supply (SRAS) curve. However, we will not get the SRAS curve until the day you hand this in. Therefore, to have the results make sense, draw an upward-sloping SRAS curve. Start with the three lines crossing at one point. The equilibrium point is where the SRAS curve crosses AD. **For this assignment only, if you move the LRAS curve, then you move the SRAS curve the same direction.** (On the day you hand this in, you will learn why movements of the LRAS curve causes movements of the SRAS curve but not vice versa, and you will learn the real shape of the SRAS curve.)

- 1) (25 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to GDP and the price level?
- 2) (25 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an improvement in technology. Explain why the curve(s) moved as drawn. What happens to GDP and the price level?
- 3) (25 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in interest rate. Explain why the curve(s) moved as drawn. What happens to GDP and the price level? (Hint: Does this affect the PPF or $C+I+G+X$?)
- 4) (10 points) What is wrong with this statement? “When the price level goes up, people cannot afford to buy as much. Therefore, people buy less. That is why the aggregate demand curve slopes down.”
- 5) (15 points) Explain why the long-run aggregate supply curve is drawn the way we drew it.