

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 160 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 14-point question should take 12 minutes. I cannot give extra time because some students have a class after your class.

1) (14 points) Answer EITHER Part A OR Part B.

A) The LRAS curve is basically the same as another curve we studied early in the semester. Which one was that? Explain why they are the same.

B) The AD curve is basically the same as another curve we studied for this test. Which one was that? Explain why they are the same.

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

A) When we estimated the government spending multiplier, what did we assume about tax revenue? If we relaxed that assumption, what happens to the size of the government spending multiplier? Explain your logic.

B) When we estimated the government spending multiplier, what did we assume about the price level? If we relaxed that assumption, what happens to the size of the government spending multiplier? Explain your logic.

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

A) If $C = 100 + .8(Y-T)$ and the person's disposable income is \$10,000. What are that person's MPC, MPS, APC, and APS. Show all work. If there is no work, explain how you got the answer.

B) If the marginal propensity to consume was actually .8, then how big would the government spending multiplier be? If government spending went up by \$1000, then how much would GDP change? Why is that not \$1000? Show all work and explain what you did.

4) (20 points) Answer EITHER Part A OR Part B.

A) Draw an LRAS/SRAS/AD diagram for an economy with a recessionary gap (high unemployment rate). Explain how you know the unemployment rate is high. If the government does nothing, how does the economy get back to full employment? Explain your logic and illustrate the effects on the diagram. Explain why the curve(s) moved as drawn.

B) Draw an LRAS/SRAS/AD diagram for an economy with an inflationary gap (unemployment rate is too low). Explain how you know the economy has too low an unemployment rate. If the government does nothing, how does the economy get back to full employment? Explain your logic and illustrate the effects on the diagram. Explain why the curve(s) moved as drawn.

5) (36 points) Answer EITHER Part A OR Part B.

A) Draw the Keynesian Cross, a.k.a. 45° diagram, and the LRAS/SRAS/AD diagram. Illustrate the effects of an increase in the marginal propensity to consume. Explain why the curves moved as drawn. What happens to the price level and GDP?

B) Draw the Keynesian Cross, a.k.a. 45° diagram, and the LRAS/SRAS/AD diagram. Illustrate the effects of an increase in the income tax. Explain why the curves moved as drawn. What happens to the price level and GDP?