

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 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 some students have a class after your class.

1) (14 points) For EITHER the aggregate demand curve OR the modern short-run aggregate supply curve, draw it and explain why it takes that shape.

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

A) We discussed three national debts, gross public debt, net public debt, and the debt Paul O'Neill discussed. Define two of them.

B) Two of the curves we discussed since Exam #2 are basically the same. Which two curves are they? Explain why they are virtually the same.

3) (14 points) When we calculated the government spending multiplier, we implicitly made many assumptions. For EITHER the variable in Part A OR the variable in Part B, what did we assume about it? If we relaxed that assumption, what would happen to the size of the multiplier? Explain your logic.

A) The price level

B) Interest rates

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

A) In my opinion, the national debt is a huge long-term problem. (See the data provided after the last question.) We discussed many problems caused by the large debt. Which do you feel is the biggest problem? Explain how the debt causes that and why that is a big problem in the long term?

B) Suppose that government spending is \$500, the tax revenue is 40% of GDP, transfers are (300 - 10% of GDP), actual GDP is \$3000, and full employment level of GDP is \$2000. Calculate the actual budget deficit or surplus and the full employment budget deficit or surplus. If you need more data, assume it is 0. Show all work and briefly explain what you did.

5) (16 points) For EITHER direct expenditure offset OR policy lags, explain how it can make countercyclical fiscal policy less effective or possibly not effective at all. Do you believe that is a problem? Explain your logic.

6) (16 points) Answer EITHER Part A OR Part B.

A) One proposal to reduce the government's budget deficit, and eventually the national debt, is to tax the rich more. How would that reduce the deficit? Would this have a major impact? Explain your logic.

B) One proposal to reduce the government's budget deficit, and eventually the national debt is to cut spending except for the military, Social Security, Medicare and Medicaid, and interest on the debt. How much of an impact would that be if they did not cut those items? Explain your logic.

7) (18 points) Illustrate EITHER the effects of the event in Part A OR the effects of the event in Part B on the Keynesian Cross Diagram, a.k.a. 45° diagram for the USA. Explain why the curve(s) moved as drawn.

A) The marginal propensity to save decreases.

B) The Canadian economy grows.

8) (20 points) Draw the LRAS/SRAS/AD diagram with the economy in the long-run equilibrium. Illustrate the effects of EITHER the event in Part A OR the event in Part B. Explain why the curve(s) moved as drawn. What happens to price level and real GDP?

A) The price of oil increases.

B) The government spending increases.

9) (22 points) Answer EITHER Part A OR Part B.

A) Draw the LRAS/SRAS/AD diagram for an economy in a recessionary gap. Explain how you know it is a recessionary gap. Illustrate how the government could use fiscal policy to get back to full employment. Explain why the curve(s) moved as drawn.

B) Draw the LRAS/SRAS/AD diagram for an economy in an inflationary gap. Explain how you know it is an inflationary gap. Illustrate how the economy would get back to full employment if left alone. Explain why the curve(s) moved as drawn and mention what the government did.

According to TreasuryDirect.gov, <http://www.treasurydirect.gov/NP/debt/current> the public debt was \$19,846,127,520,117.50 on 2017/4/26. According to the Census Bureau's population clock at 2:00 PM on 2017/4/26 <http://www.census.gov/popclock/>, the population was about 324,936,086 people. That means the debt is \$61,077.02 per person. According to NASA, http://map.gsfc.nasa.gov/universe/uni_age.html, the solar system started 4,500,000,000 years ago. Therefore, if you earned 1 penny for 5 out of every 6 minutes (without earning interest) from the start of the solar system, you would not have enough to pay the debt. The debt-to-GDP ratio is 1.069. Therefore, the government owes 106.9% of the entire GDP. The GDP data was gotten from <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>.