

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 16-point question should take 8 minutes. Because of the class that follows your class, I cannot give you extra time.

1) (10 points) Do EITHER Part A OR Part B.

A) Why should $S = I$?

B) Why did the classical school of thought conclude the SRAS curve is vertical?

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

A) Explain why the AD curve slopes downward to the right.

B) Explain why the LRAS curve takes its shape.

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

A) Suppose that a person's consumption function is given by $C = 500 + 0.9Y$. If their income is \$10,000, then how much is their MPC, APC, MPS, and APS. If their income is \$20,000, then how much is their MPC, APC, MPS, and APS. Show all work.

B) Explain the multiplier process that causes a \$1 increase in government spending to cause more than a \$1 increase in GDP. What would happen to the size of the multiplier if the tax was changed to an income tax? Explain your logic.

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

A) Illustrate on the Keynesian Cross, a.k.a. 45° diagram, an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, what is the value of the multiplier, a.k.a. autonomous expenditure multiplier? Explain how you got that number.

B) Illustrate an increase in the MPC on the Keynesian Cross, a.k.a. 45° diagram. Explain why the curve(s) moved as drawn.

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

A) During both of the OPEC oil crises, the price of oil more than doubled. Illustrate that event on the LRAS/SRAS/AD diagram. Explain why the curve(s) moved as drawn.

B) Illustrate on the LRAS/SRAS/AD diagram a situation that would cause *cost push inflation*. Explain what caused the curve(s) to move and how the diagram shows *cost push inflation*.

6) (28 points) For EITHER the event in Part A OR the event in Part B, illustrate that event on BOTH the SRAS/LRAS/AD diagram and the Keynesian Cross, a.k.a. 45° diagram. Use the **same** event for both diagrams and explain why the curve(s) moved as drawn.

A) Income taxes go up.

B) Interest rates go up.