

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 7 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) Suppose that the government spends \$100. Explain why GDP will go up by more than \$100.
- B) Explain why transfer payments are treated like negative taxes.

2) (14 points) Explain EITHER the equation in Part A OR the equation in Part B.

- A) $M_d = f(i, Y)$ where M_d is the liquidity demand for money, sometimes called L .
- B) $i = f(Y, P)$, where we are drawing the LM curve.

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

- A) The money supply is important in the economic theory we have been developing. Given what we have done so far, would M1, M2, or M3 be the one that best fits our theory? Explain your logic including a list of what is in each of the three categories.
- B) What is meant by the neutrality of money? Explain how money could be neutral. (The Classical school had neutrality of money.)

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

- A) Suppose investment is sensitive to interest rates. Draw the IS/LM diagram that corresponds to that situation. Explain how you can tell the graph illustrates investment's sensitivity to the interest rate.
- B) Suppose money demand is sensitive to interest rates. Draw the IS/LM diagram that corresponds to that situation. Explain how you can tell the graph illustrates money demand's sensitivity to the interest rate.

5) (44 points) Illustrate EITHER the event in Part A OR the event in Part B on the IS/LM, AS/AD, MS/MD, and Keynesian Cross (45°) diagrams. Use the same event for all four graphs. Explain why the curves moved as drawn.

- A) There is an improved technology.
- B) The money supply increases.