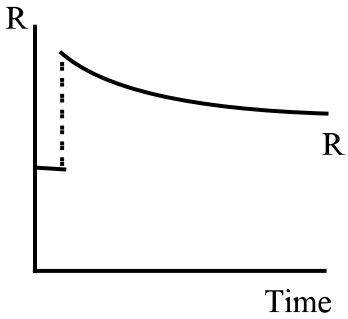
Write your name on the cover of the test booklet and nowhere else. Enclose this sheet with the booklet. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 300 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 16-point question should take 8 minutes. You can some extra minutes, but not many.

1) (12 points) Do EITHER Part A OR Part B.
A) Explain the cause of the *Dutch Disease*.
B) Draw on the supply and demand for £, the effect of an increase in the interest rate in the UK. BRIEFLY state why the curve(s) moved as drawn.

2) (14 points) Do EITHER Part A OR Part B.
A) Draw the supply and demand for the Nigerian ₦ priced in US$. Have the diagram show an unstable exchange rate. Prove the exchange rate is unstable.
B) If we drew the supply and demand for US exports priced in ¥, then would we be deriving the supply or demand for ¥? Why did you make that choice. Would your answer be different if the supply and demand for the US exports were priced in US$? Explain your logic.

3) (16 points) Do EITHER Part A OR Part B.
A) Without drawing the supply and demand for a good, explain why the supply of money on the foreign exchange market could be upward or downward sloping. Explain the economics behind that conclusion.
B) Use the Marshall-Lerner Condition to explain the J-Curve.

4) (16 points) Do EITHER Part A OR Part B.
A) Chapter 15 has a graph that looks like the one to the right. It shows what happens to R when there is a one-time increase in the money supply. Explain why the curve takes that shape.
B) What is the identification problem? Explain why that caused *elasticity pessimism*



5) (16 points) Do EITHER Part A OR Part B.
A) For the equation $\frac{\partial Y_1}{\partial I_1} = \frac{1 + MPM_2 / MPS_2}{MPS_1 + MPM_1 + MPM_2(MPS_1 / MPS_2)}$, explain the economic reason for the MPM_2/MPS_2 in the denominator and in the numerator. Do not worry about any of the MPM_1 or the MPS_1.
B) Use the concept of foreign repercussions and the equation $\frac{\partial Y_1}{\partial I_2} = \frac{MPM_2 / MPS_2}{MPS_1 + MPM_1 + MPM_2(MPS_1 / MPS_2)}$ to determine whether an economic downturn in the Japan is likely to have a negative or a positive effect upon the rest of the world.

6) (18 points) Illustrate EITHER the event in Part A OR the event in Part B on the Keynesian cross, a.k.a. 45° diagram. Explain why the curve(s) moved as drawn.
A) The marginal tax rate increases.
B) The marginal propensity to import increases.

7) (18 points) For EITHER the equation in Part A OR the equation in Part B, explain how an increase the different variables inside the function affect the variable on the left-hand side of the equal sign? Explain both the direction and the reason for those effects.
A) M = f(i, i*, EA, RP, Y, P, W)
B) F = f(i, i*, EA, RP, Y, P, W)

8) (20 points) Do EITHER Part A OR Part B.
A) Illustrate on the Keynesian cross, a.k.a. 45° diagram, an increase in government spending. Use your diagram to estimate the autonomous expenditure multiplier. Explain why the curve(s) moved as drawn and how you estimated the multiplier.
B) Back in the 1994, I was at a conference in Virginia. A paper was trying to find the impact of a decrease in government spending (at the Naval Shipyard in Norfolk, VA) upon the economy of the Norfolk area. Remembering that the paper was only looking at the local area, use the equation in question 5A to estimate the multiplier. Explain how you chose the values for the different terms. (I hope you do not come up with the multiplier the paper assumed, 10.)

9) (20 points) Answer EITHER Part A OR Part B.
A) State both *absolute PPP* and *relative PPP*. Explain why the *absolute PPP* may not hold, AND why the *relative PPP* may still hold even when *absolute PPP* does not.
B) The book describes what it calls the "monetary approach to the exchange rate." It is an equation that involves the money supplies of the two countries, the constants k and k*, and the money supplies of the two countries. State the equation. Explain whether R is other currency/$ or $/other currency, and why changes in M_s, M^*_s, Y, and Y* affect R in the manner described by the equation.