

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 save some extra minutes, but not many.

- 1) (10 points) Explain why EITHER the BP curve OR the LM curve slopes the way we drew it.
- 2) (14 points) Do EITHER Part A OR Part B.
 - A) Is the AD curve flatter with a closed economy or an open economy with a flexible exchange rate? Explain your logic.
 - B) Which line on the SRAS/LRAS/AD diagram normally moves when the IS curve moves? Why do those two curves usually move together?
- 3) (14 points) For EITHER the requirement in Part A OR the requirement in Part B, explain why countries had to meet that requirement to become part of the Euro-zone.
 - A) The budget deficit must not exceed 3% of GDP.
 - B) The inflation rate must not exceed by more than 1.5 percentage points the average rate of the three Community nations with the lowest rates.
- 4) (14 points) For EITHER the exchange rate regime in Part A OR the exchange rate regime in Part B, explain why a country might want that regime. Then explain the disadvantage of using that regime.
 - A) Crawling peg with band.
 - B) Managed, a.k.a. dirty, float.
- 5) (14 points) Answer EITHER the question in Part A OR the question in Part B.
 - A) Explain why fixed exchange rate systems often fall apart.
 - B) Explain the drawbacks and advantages of dollarization.
- 6) (14 points) Do EITHER Part A OR Part B. Both refer to the figure on the right.
 - A) Which point is the economy at? Is there a balance of payments deficit or surplus? If the marginal propensity to import (MPM) is 0.15 and there are no foreign repercussions, then how much is the balance of payments surplus or deficit? Explain how you came to all three conclusions.
 - B) Assume there is a fixed exchange rate. If the government wanted to be at Y_E and to have an external balance in the balance of payments, then which point would they want to get to? Using fiscal and monetary policy, how could they get there? Explain how you came to those two conclusions.
- 7) (24 points) Illustrate EITHER the event in Part A OR the event in Part B on the IS/LM/BP diagram. Assume that the BP line is steeper than the LM curve and that there is a fixed exchange rate. Explain the movement(s) of the curve(s). Make sure it ends in equilibrium in all markets.
 - A) Canada's GDP increases.
 - B) There is an autonomous increase in consumption.
- 8) (40 points) Illustrate EITHER the event in Part A OR the event in Part B on the IS/LM/BP diagram **and** the SRAS/LRAS/AD diagram. Assume the LM curve is steeper than the BP curve and there are flexible exchange rates. Explain the movements of all curves that moved. Use the same event for both graphs.
 - A) Government spending increases.
 - B) The money supply increases.

