

Write your name on the cover of the test booklet and nowhere else. 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. I can give some extra time, but not much.

1) (14 points) Answer EITHER Part A OR Part B.

A) Briefly explain two of the three reasons why the AD curve slopes down.

B) Why does the classical SRAS curve look like we drew it.

2) (16 points) Answer EITHER Part A OR Part B.

A) The book and the review sheet and the book say that an increase in the marginal income tax and an increase in the sales tax will move different curves on the SRAS/LRAS/AD diagram. Which event moves which curve? Why?

B) Every time one specific curve of on the LRAS/SRAS/AD diagram moves, another specific curve moves. What are these two curves and why must the second curve move when the first one moves?

3) (18 points) Illustrate EITHER the event in Part A OR the event in Part B on the  $45^\circ$  diagram, a.k.a. Keynesian Cross diagram. Explain why the curve(s) moved as drawn.

A) interest rates increase.

B) The government increases the salaries of the President and Congress.

4) (20 points) Answer EITHER Part A OR Part B.

A) Draw an inflationary gap on the SRAS/LRAS/AD diagram. Explain how the problem will solve itself without government intervention. Illustrate that on the diagram.

B) Use the graph of S and I vs.  $i$ , to illustrate a drop in the savings rate. Explain why the curve(s) moved as drawn. What is the bad side effect of this for the future of the economy. Explain your logic.

5) (32 points) Answer EITHER Part A OR Part B.

A) Illustrate an increase in oil prices on **both** the LRAS/SRAS/AD diagram **and** the  $45^\circ$  diagram, a.k.a. Keynesian Cross diagram. Explain why the curve(s) moved as drawn. (Hint: the change in GDP on one graph should be the same as the change in GDP on the other graph.)

B) Illustrate an increase in the MPC on **both** the LRAS/SRAS/AD diagram **and** the  $45^\circ$  diagram, a.k.a. Keynesian Cross diagram. Explain why the curve(s) moved as drawn. (Hint: the change in GDP on one graph should be the same as the change in GDP on the other graph.)