

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 12-point question should take 6 minutes. I cannot give extra time because some students have a class after your class.

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

A) We initially estimated that the government spending multiplier was 10. If that is correct and the government spends \$500, then how much will GDP eventually increase? Why isn't that \$500?

B) We initially estimated that the government spending multiplier was 10. How would this estimate change if there was an income tax? Explain your logic.

2) (12 points) Answer EITHER Part A OR Part B.

A) Draw the original Keynesian SRAS Curve. Explain why it looks as drawn.

B) Draw the AD Curve. Explain why it looks as drawn. (This one is tougher than it looks.)

3) (12 points) Answer EITHER Part A OR Part B.

A) Explain how *cost push inflation* got its name. You do NOT need to draw a graph.

B) What is meant by a *demand shock*? Explain how it would affect the SRAS/LRAS/AD diagram **without** drawing the graph.

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

A) Illustrate the effects of a decrease in government spending the on the 45° diagram, a.k.a. the Keynesian Cross diagram. Explain why the curve(s) moved as drawn. What happens to GDP?

B) Illustrate the effects of a decrease in autonomous consumption the on the 45° diagram, a.k.a. the Keynesian Cross diagram. Explain why the curve(s) moved as drawn. What happens to GDP?

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

A) The book says that an increase in the marginal business tax will have a different effect than an increase in the marginal personal income tax on the SRAS/LRAS/AD diagram. Explain why they are different. Illustrate an increase in **one** of the two taxes. Explain why the curve(s) moved as drawn.

B) Every time the LRAS Curve moves, the SRAS Curve will also move. However, the converse is not true. Explain why movements in the LRAS Curve must cause movements of the SRAS Curve **using** the LRAS/SRAS/AD diagram. Explain why movements in the SRAS Curve may not correspond to movements in the LRAS Curve **without** drawing the diagram.

6) (32 points) Answer EITHER Part A OR Part B.

A) Illustrate the effects of an increase in the MPC on the LRAS/SRAS/AD and the 45° diagram, a.k.a. the Keynesian Cross diagram. Explain why the curves moved as drawn. What happens to prices and GDP?

B) Illustrate the effects of an increase in the interest rate on the LRAS/SRAS/AD and the 45° diagram, a.k.a. the Keynesian Cross diagram. Explain why the curves moved as drawn. What happens to prices and GDP?