

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 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I can give some extra time, but not much.

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

A) In the definition of the business cycle, there is a discussion of “aggregate economic activity.” What does that mean? What is the disadvantage of looking at that?

B) The definition of the business cycles includes the word “persistent”. Why is it important to look at persistent changes?

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

A) Why do some economists say we cannot tell if the business cycles have become less severe?

B) Why does economic theory conclude the business cycles should be less severe now?

3) (12 points) Explain EITHER the equation in Part A OR the equation in Part B.

A) $MD/P = F(Y, r, \pi)$

B) For the LM curve, $r = F(Y, MS/P, \pi)$. Treat MS/P as one variable.

4) (14 points) For EITHER inflation OR initial claims for unemployment benefits. Determine if that variable is leading, lagging, or roughly coincident. Explain your logic. Also determine if it is procyclical or countercyclical. Explain your logic.

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

A) Use the IS/LM/FE diagram to explain the neutrality of money.

B) Draw the IS/LM/FE diagram with the economy in a recessionary gap. Explain how the diagram gets to full employment if the government does nothing.

6) (18 points) Answer EITHER Part A OR Part B.

A) Draw the real MS/MD diagram. Illustrate the effects of a decrease in the price level. Explain why the curve(s) moved as drawn. What happens to the real money supply and the real interest rate?

B) Draw the real MS/MD diagram. Illustrate the effects of an increase in government spending. Explain why the curves moved as drawn. What happens to the real money supply and real interest rate? What is the bad long-term impact of this movement? Explain your logic.

7) (18 points) Answer EITHER Part A OR Part B.

A) Draw the LRAS/SRAS/AD diagram. Illustrate the effects of a decrease in the price of oil. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

B) Draw the LRAS/SRAS/AD diagram. Illustrate the effects of an expected decrease in the income tax in the future. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

8) (48 points) Answer EITHER Part A OR Part B.

A) Draw the IS/LM/FE, SRAS/LRAS/AD, and real MS/real MD diagrams. Illustrate the effects of the Federal Reserve selling bonds. Explain why the curves moved as drawn. What happens to the real interest rate, price level, and real GDP?

B) Draw the IS/LM/FE, SRAS/LRAS/AD, and real MS/real MD diagrams. Illustrate the effects of the Congress raising taxes. Explain why the curves moved as drawn. What happens to the real interest rate, price level, and real GDP?