

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 150 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. You can take the full hour and a half.

1) (10 points) Explain why EITHER the AD curve OR the LM curve takes its shape.

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

A) Explain two reasons why you cannot just look at the unemployment rates in two countries and say one country is better off than the other.

B) Explain why it is best to assume that *Ricardian Equivalence* does not hold when answering Part 2 of the Final Exam next Tuesday.

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

A) Suppose there is a negative supply shock. Without drawing the S/I diagram, would there be a bigger change in the interest rate if the economy was closed, small open, or a large open economy? Explain the economic reason.

B) Assume that developing countries have high population growth rates and their capital depreciates quickly. Without drawing the growth model diagram, what can we say about their long-run capital to labor ratio and output per worker? Explain your logic. (Note that those assumptions are not always true.)

4) (14 points) Answer EITHER Part A OR Part B.

A) Explain $uc_K = (r + d)p_K$.

B) Explain $S_{govt} = (T - TR - INT) - G$

5) (16 points) Answer EITHER Part A OR Part B.

A) The government wants the economy to grow. Given the equation $\frac{\Delta Y}{Y} = sA - d$, what two economic policies can the government do to stimulate long-run growth. Explain how they will help growth.

B) Draw an IS/LM/FE diagram with an unemployment rate that is too high. Illustrate what will happen if the government takes no action. Explain why the curve(s) moved as drawn.

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

A) Illustrate on the real supply and demand for money an increase in the risk of stocks. Explain why the curve(s) moved as drawn. Explain what happens to the variables on the axes and the economic reason for the change(s).

B) Use the Solow Growth Model to illustrate an improvement in technology. Explain why the curve(s) moved as drawn. Explain why the variables on the axes changed as drawn.

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

A) Illustrate an increase in the income tax on the labor supply and demand diagram. Explain why the curve(s) moved as drawn. What happens to the variables on the two axes? What is the economic reason for that?

B) Draw a diagram which would explain why a temporary increase in income will have little effect upon consumption. Explain how the diagram yields that result.