

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 170 points) and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 10-point question should take 5 minutes. I cannot give extra time because some students have a class after your class.

1) (12 points) Answer EITHER Part A OR Part B.

A) President George W. Bush's initial tax cut was supposed to be a temporary cut. What would economic theory predict about its impact upon GDP? Explain why that may be the case.

B) Durable goods cause problems for both Modigliani's *Life Cycle Model* and Friedman's *Permanent Income Hypothesis*. Explain the problem they cause.

2) (14 points) Answer EITHER Part A OR Part B.

A) Explain two reasons why a decrease in the unemployment rate may be a bad sign for the economy.

B) Explain two reasons why an increase in real GDP per capita may not mean an increase in production.

3) (16 points) Answer EITHER Part A OR Part B.

A) The welfare of which part of society is measured by NI? Explain your logic by comparing it to PI and NNP.

B) What are the three ways of calculating GDP? Why should they give the same result?

4) (24 points) Explain EITHER the equation in Part A OR the equation in Part B.

A) $c_{t+1} = (y_t + a_t - c_t)(1 + r) + y_{t+1}$. Also explain why the $(y_t + a_t - c_t)$ is multiplied by $(1+r)$.

B) $S_{pvt} = (Y + NFP + TR - T - INT) - C$

5) (34 points) Illustrate EITHER the event in Part A OR the event in Part B on the NS/ND diagram AND the production function diagram with N on the horizontal axis. Use the same event for both diagrams. What happens to GDP, the real wage rate, and the level of employment? Explain why the curve(s) moved as drawn.

A) Wealth increases.

B) Technology improves.