

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 cannot give extra time because some students have a class after your class.

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

A) In general, how do we calculate the CPI? What is one problem with doing this?

B) I bought 2000 shares of Citigroup for \$1/share earlier this year. I paid \$8.95 in commissions. How much did GDP change? If it did not, explain why it did not. If it did, then tell me which part of GDP changed and why you chose that part.

2) (12 points) For EITHER *letting “creative destruction” run its course* OR *limiting protectionism*, explain what that means and how that helps the economy to grow and develop.

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

A) Explain why the AD curve slopes down.

B) What information do you need to know to get from National Income to Personal Income. Explain how you would use this information.

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

A) Suppose the expected inflation rate was 5%. If the price level at the beginning of the year was 200 and at the end of the year was 206, then name two groups of people who would benefit from this situation. Explain how they benefit.

B) There are two costs of high, but fully anticipated, inflation. Which one disappears when there is hyper-inflation? Explain what that cost is and why it disappears with very high inflation.

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

A) Explain TWO of the three methods for calculating GDP. (Expenditures, value added, and income). Explain why they should give the same value for GDP.

B) Explain two reasons why faster economic growth may hurt the country.

6) (20 points) Answer EITHER Part A OR Part B.

A) Illustrate an increase in the interest rate on the SRAS/LRAS/AD diagram. Explain why the curve(s) moved as drawn. What happens to the price level and GDP?

B) Illustrate an increase in the income tax rate on the SRAS/LRAS/AD diagram. Explain why the curve(s) moved as drawn. What happens to the price level and GDP?

7) (20 points) Answer EITHER Part A OR Part B.

A) According to a UN document I have, the Democratic Republic of Congo’s real GDP per capita using PPP is \$281. Why is that probably underestimating the output of the country? Give at least two reasons. What is meant by “using PPP”?

B) Each year, Johan typically does all his own landscaping and yard work. He spends \$200 per year on mulch for his flower beds, \$225 per year on flowers and plants, \$50 on fertilizer for his lawn, and \$245

on gasoline and lawn more maintenance. It takes him 100 hours to do all this work each year. If he could earn \$10/hour at work, what is the total cost of his yard work? How much does he contribute to GDP each year? Show all work and briefly explain your answers to each part.

8) (20 points) Answer EITHER Part A OR Part B.

A) Illustrate an increase in the price of oil on the SRAS/LRAS/AD diagram. Explain why the curve(s) moved as drawn. What happens to the price level and GDP?

B) Illustrate an increase in the amount of capital on the SRAS/LRAS/AD diagram. Explain why the curve(s) moved as drawn. What happens to the price level and GDP?

9) (24 points) Answer EITHER Part A OR Part B.

A) Draw the SRAS/LRAS/AD diagram with an inflationary gap. Illustrate what will happen if the government does nothing. Explain how you know we have an inflationary gap, why the curve(s) moved as drawn, and what happens to the price level and GDP.

B) Draw the SRAS/LRAS/AD diagram with the current high unemployment rate. Illustrate what will happen if the government does nothing. Explain how you know we have high unemployment, why the curve(s) moved as drawn, and what happens to the price level and GDP.