

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 150 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 I have a class after your class.

1) (12 points) Explain EITHER $S_{PVT} = (Y + TR) - (T + C)$ OR $S_{GVT} = T - (G + TR + INT)$.

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

A) Using the equation for the Endogenous Growth Theory, explain why President George W. Bush cut the tax rate on dividends.

B) State Ricardian Equivalence. Is it more likely to occur with a tax cut or an increase in government spending? Explain your logic.

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

A) Explain how durable goods can cause Modigliani's Life Cycle Model problems when applying it to the real world. Given an example which shows how the model can result in a wrong prediction.

B) Last Friday, the unemployment rate for April was announced. It had dropped from March's unemployment rate of 6.7% to 6.3%. I heard an economist on the radio say that the drop was both good news and bad news, but mostly bad news. Explain both how it could be good news and how it could be bad news.

4) (18 points) Answer EITHER Part A OR Part B.

A) Draw the labor supply/labor demand diagram. Illustrate effects of an increase in the income tax. Explain why the curve(s) moved as drawn. What happens to the level of employment and the real wage rate?

B) Draw the inter-temporal budget constraint. Illustrate the effects of a decrease in the interest rate. Explain why the curve moved as drawn.

5) (20 points) Answer EITHER Part A OR Part B.

A) Draw the S/I diagram for a small open economy with a CA deficit. Explain how you know it is a CA deficit. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to the interest rate, level of savings, level of investment, and the CA deficit?

B) Draw the MPK^f/uc_K diagram. Illustrate the effects of an increase in the depreciation rate. Explain why the curve(s) moved as drawn. What happens to the user cost of capital, the desired amount of capital, and the level of investment? State how you reached your conclusion.

6) (20 points) The USA has a faster growth rate of population than most developed countries and we have a smaller savings rate. Draw ONE Solow Growth model comparing the USA to other developed countries for EITHER the different population growth rates OR the different savings rates. Draw both country's diagrams on the same graph. Explain why the two countries have different lines. Given your diagram, do you think the USA will continue to be the dominate economy in the future? Explain your logic.