

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 14-point question should take 7 minutes. Because of the class that follows your class, I cannot give you extra time.

1) (14 points) Answer EITHER Part A OR Part B.

A) We assume that a bigger GDP means the country is better off. However, there are multiple problems with this assumption. Explain two of them.

B) Draw the BP line. What are two things that will move it? Illustrate them and explain why it moved as drawn.

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

A) Suppose the economy was described by the equations $C = 200 + 0.9(Y-T)$, $I = 400 - 300i$, $G = 300$, $T = 0.4Y$, $X = 300 - 0.29Y$, $M^S = 300$, and $M^D = 0.5Y - 300i$, where X is net exports, T is net taxes, and M is money. Derive EITHER the IS curve OR the LM curve OR the equilibrium level of GDP. Show all work.

B) Explain the equation $Y = 1000 + 4G - 1000i$. Explain why a change in one variable on the right-hand side of the equation will change the variable on the left-hand side. Do not explain the numbers. Which line is this? How can you tell?

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

A) Mathematically, Friedman's theory of consumption and Modigliani's theory of consumption appear to be very different. However, there are major similarities. Explain two similarities.

B) How do the elasticity of supply of capital and the durability of capital affect the interest elasticity of demand for investment?

4) (18 points) Illustrate EITHER the event in Part A OR the event in Part B on the IS/LM diagram. Explain why the curve(s) moved as drawn.

A) The marginal propensity to import increases.

B) The velocity of money increases.

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

A) Draw the classical AS/AD diagram. Illustrate an increase in consumption. Explain why the curve(s) moved as drawn. Explain why GDP changed or did not change.

B) Illustrate on the supply and demand for euros, i , an increase in our prices. Explain why the curve(s) moved as drawn. Which currency appreciated? How can you tell?

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

A) The *Balanced Budget Amendment* is controversial among economists. Explain one argument for it and one argument against it. Which side would you choose? Why did you make that choice?

B) Use the IS/LM/BP diagram to illustrate an increase in autonomous consumption. Explain why the curve(s) moved as drawn. Make sure the economy starts and ends in equilibrium in all three

markets shown on the graph.