

NAME: _____

Cooleconomics.com
Principles of Economics

Exam 2 version 1

Instructions (Read Carefully and Follow Precisely):

You have 45 minutes to complete this closed-notes, closed-book, 100-point exam. (You may use a 1-sided 8.5x11" notes sheet and a calculator whose memory and programming are cleared.) You must not collaborate with any other person in any way on this exam. You must not view anyone else's exam.

1. (27 points). An economy with no foreign sector and fixed interest rates is represented below.

$$C = 500 + .6Y_d \quad I = 600 \quad G = 400 \quad T = 900$$

Calculate the following:

Equilibrium gross domestic product _____

Equilibrium personal savings _____

Change in taxes required to achieve full employment GDP of 2000. _____

(Along with your specific numerical response, clearly indicate whether taxes must *increase* or *decline*)

Calculations (required):

2. (63 points) The President and Congress are implementing substantial income tax reductions.

Below, you will use model #4 (of an open economy in the short run with flexible interest rates and prices) to analyze the **short run** effects on equilibrium values of variables in the economy of the income tax reductions.

Seven variables are listed below and on the next page. For each variable, indicate whether it will *increase*, *decrease*, or remain *unchanged* if income taxes are reduced. **Explain each forecast carefully**, using information from class consistent with model #4; your score depends ENTIRELY upon the thoroughness and accuracy of your explanations.

Trade deficit ____ increase ____ decrease ____ unchanged

Budget surplus ____ increase ____ decrease ____ unchanged

Personal savings ____ increase ____ decrease ____ unchanged

Investment ____ increase ____ decrease ____ unchanged

Unemployment rate ____ increase ____ decrease ____ unchanged

Consumption ____ increase ____ decrease ____ unchanged

National Income ____ increase ____ decrease ____ unchanged

3. (10 points) Recently the Federal Reserve System conducted a large open market purchase of government securities. Using model #5, graph the short run and long effects of this purchase on GDP and the average price level. (Fully label your graph.) (No explanations are required).