

NAME: \_\_\_\_\_

**Cooleconomics.com**  
**Principles of Macroeconomics**

**Exam 2**

**Instructions (Read Carefully and Follow Precisely):**

You have 50 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.

Write legibly and coherently, please. **You MUST show all calculations to receive any credit for answers that require calculations** (Answers might not be whole numbers). Label all axes, curves, and points on graphs. Good luck!

**1. (25 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*)

Carefully depict equilibrium national income on a graph below:

Calculations (required):

**2. (63 points)** Suppose that the next U.S. President proposes substantial income tax reductions and substantial increases in transfer payments.

Below, you will use model #3 (of an open economy in the short run with flexible interest rates and fixed prices) to analyze the short run effects on equilibrium values of variables in the economy, assuming that the proposals are implemented.

Eight variables are listed below and on the next page. For each variable, indicate whether it will *increase*, *decrease*, or remain *unchanged* if the proposals are implemented. **Explain each forecast carefully**, using information from class consistent with model #3; 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

External debt      \_\_\_\_\_ increase      \_\_\_\_\_ decrease      \_\_\_\_\_ unchanged

Unemployment rate      \_\_\_\_\_ increase      \_\_\_\_\_ decrease      \_\_\_\_\_ unchanged

Consumption      \_\_\_\_\_ increase      \_\_\_\_\_ decrease      \_\_\_\_\_ unchanged

National Income      \_\_\_\_\_ increase      \_\_\_\_\_ decrease      \_\_\_\_\_ unchanged

**2. (finished)** Use two completely-labeled graphs to illustrate the changes, if the new President's tax and spending proposals are implemented, to equilibrium GDP and average interest rates.

**3. (12 points)** Name three methods that the Fed can employ to increase short run average interest rates. Describe each method in 1 sentence each.