

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 160 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 some students have a class after your class.

1) (10 points) Answer EITHER Part A OR Part B.

A) Why does Paul O'Neill say the government owes more than the \$12,034,545,227,295.68 that the government owes at the point I am writing this. (By the way, the same source says that number is \$39,159.89 per citizen and that the government has borrowed \$3,870,000,000.00 per day on average since Sept. 28, 2007.)

B) Use the equation $MV = PY$ to explain what classical economists feel is the long-term effect of expansionary monetary policy. You do NOT need to explain why that equation holds, rather, just explain how it is used.

2) (12 points) For ONE of the following events, determine what happens to M1 and M2. Briefly explain your logic.

A) You deposit \$500 cash into a savings account.

B) You pay the bookstore \$452 for books for next semester with a credit card.

C) You take \$900 from your checking account and put it into a certificate of deposit.

3) (14 points) For EITHER Ricardian Equivalence OR Lags, explain what it is and what it means about the effectiveness of fiscal policy.

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

A) What is adverse selection? Explain why it causes us to use financial intermediators?

B) What is moral hazard? How does it the FDIC insurance make the problem worse?

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

A) For TWO of the three biggest parts of the government's budget, explain why it is hard to cut that part of the budget.

B) I said that China's actions have caused us big political headaches on the "world stage" but have greatly benefitted our economy's long-term growth. Explain how it has both of those effects.

6) (16 points) Answer EITHER Part A OR Part B.

A) Illustrate an increase in GDP on the supply and demand for money. Explain why the curve(s) moved as drawn. What happens to interest rates.

B) Illustrate an increase in the money supply on the supply and demand for money. Explain why the curve(s) moved as drawn. Without drawing the SRAS/LRAS/AD diagram, explain how the AD Curve would move and why it moved that way.

7) (18 points) Answer EITHER Part A OR Part B.

A) Draw the SRAS/LRAS/AD diagram for an economy in a recessionary gap. Explain how you can tell it is an inflationary gap. What fiscal policy should the government do? Illustrate that policy on the graph and why the graph moves as drawn. What happens to GDP and inflation?

B) Suppose the government spending is \$500, the formula for transfers is $\$725 - 0.1Y$, the formula for tax revenue is $0.2Y$. If GDP is \$4000 and the full-employment level of GDP is \$5000, then how much is the budget deficit or surplus, and how much is the full-employment budget deficit or surplus? Show all work and briefly explain what you did.