

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) The book claims that the stated debt is too large. What is their argument? (Personally, I disagree with it.)

B) What are the three tools the Fed has to affect the money supply?

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 *crowding out*, 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 how it applies to health insurance.

B) What is moral hazard? Explain how it applies to car insurance.

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

A) Explain why our government should run a deficit now. Given that we should have a deficit, how can we tell if it is actually too big?

B) What are the *twin deficits*? Why are they called that?

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

A) Illustrate an increase in prices 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 inflationary gap. Explain how you can tell it is an inflationary gap. What would happen if the government did nothing? Illustrate that event 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.