

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 10-point question should take 5 minutes. I cannot give extra time because some students have a class after your class.

1) (8 points) For EITHER the event in Part A OR the event in Part B, determine what happens to M1 and M2. Explain your logic.

- A) You deposit your \$50 paycheck into a savings account.
- B) You use your credit card to buy a \$400 stereo system.

2) (10 points) Answer EITHER Part A OR Part B.

- A) Why do we use financial intermediaries?
- B) What is meant by “liquidity”? Why is it important to the study of money?

3) (14 points) For EITHER the argument in Part A OR the argument in Part B, explain the argument about the problems with the government’s deficit and debt. Determine how valid it is. Explain your reasoning for whether or not the argument is valid.

- A) High interest payments cause problems.
- B) Crowding out.

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

- A) How are the government deficit and the trade deficit related? Explain the economic causation.
- B) Why are the short-run and long-run effects of the deficit different?

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

- A) Suppose a person often does not pay their debts. If they are trying to get a loan, what is the economic term for this? Explain your logic. How can the banks avoid this problem? Explain how that will reduce the problem.
- B) Suppose that after a person gets a loan, they change their mind and use it to gamble. What is the economic term for this? Explain your logic. How can the banks avoid this problem? Explain how that will reduce the problem.

6) (18 points) Answer EITHER Part A OR Part B.

- A) Suppose that government spending is $G = 1000$. The tax revenue is $T = -20 + 0.2 * Y$. The current GDP is 5200 and the full-employment level of GDP is 5000. What are the government deficit/surplus and the full-employment government deficit/surplus? Show all work. Do you think this government is doing good fiscal policy? Explain your logic. (Yes, it is a negative sign in front of the 20 in $T = . . .$)
- B) What are the automatic stabilizers? Why are they called that? What is the economic reason I put a negative sign in front of the 20 in the equation in Part A?

7) (20 points) Answer EITHER Part A OR Part B.

- A) Illustrate an **inflationary gap** on the SRAS/LRAS/AD diagram. State how you know it is an inflationary gap. What should the government do if it was to solve the problem? Explain your logic and illustrate it on the diagram. Explain why the curve(s) moved as drawn. What happened to the price level and the GDP?
- B) Illustrate a **deflationary gap** on the SRAS/LRAS/AD diagram. State how you know it is an deflationary gap. What fiscal policy should the government do if it was to solve the problem? Explain your logic and illustrate it on the diagram. Explain why the curve(s) moved as drawn. What happened to the price level and the GDP?