

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) (12 points) For EITHER the event in Part A OR the event in Part B, explain how it affects M1 and M2. Explain your logic.

A) You deposit \$50 cash into your savings account.

B) You pay for \$80 for a book using your debit card to take it out of your checking account.

2) (12 points) Answer EITHER Part A OR Part B.

A) Donald Trump says in an advertisement that he will give the middle class a tax cut, save Social Security without cutting it, and strengthen the military. Assuming he does that, what will happen to the budget deficit? Explain your logic.

B) Ted Cruz says in an advertisement that he will eliminate the IRS and cut wasteful spending.

Assuming that eliminating the IRS means eliminating the income tax and only relying on the other taxes, what will happen to the budget deficit? Explain your logic.

3) (12 points) Answer EITHER Part A OR Part B.

A) Suppose the US economy had an unemployment rate of 4% and the government's budget was balance. Would be the government's full employment budget be a deficit or a surplus? Explain your logic.

B) Explain the difference between the debt that Paul O'Neill talks about and the gross public debt. Which would be more likely to negatively affect the government's budget in the future? Explain your logic.

4) (14 points) Define EITHER moral hazard OR adverse selection. Give an example of it from banking.

5) (14 points) Answer EITHER Part A OR Part B.

A) Some people say the government's debt is a problem because the high interest payments hurt the country. Explain the logic.

B) Explain the difference between the government's debt and its deficit.

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

A) Draw the MS/MR diagram. Illustrate the effects of the Fed buying bonds. Explain why the curve(s) moved as drawn. What happens to the interest rate and the amount of money?

B) Draw the MS/MR diagram. Illustrate the effects of an increase in the price level. Explain why the curve(s) moved as drawn. What happens to the interest rate and the amount of money?

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

A) Draw the LRAS/SRAS/AD diagram for a country in a recessionary gap. State how you know it is a recessionary gap. What type of fiscal policy would be best for that? Illustrate the effects of that policy on the diagram. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

B) Suppose the government wants to expand the economy. What could they do to achieve that? Explain how that would impact the economy and why it would have that impact. Crowding out will make this policy less effective. Explain why it makes the policy less effective.