

Write your name on the cover of the test booklet and nowhere else. Failure to follow these directions will cost you 1 point. The test has 150 points (to be scaled up to 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 16-point question should take 8 minutes. I will allow some extra time, but I will not allow much.

1) Use the table to the right to answer the following questions. Do BOTH parts.

A) (10 points) How much is the equity? Show all work or explain your logic.

B) (10 points) How much excess reserves does this bank have? Show all work or explain your logic.

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

A) Explain how money could be used as a unit of account, but not as a medium of exchange.

B) Why can't the central bank control both the interest rates and the money supply at the same time?

3) (14 points) Crowding out and policy lags are two problems with fiscal policy. For ONE of them, explain why it causes problems for fiscal policy.

4) (16 points) Do EITHER part A OR part B.

A) If the Federal Reserve buys \$100 worth of bonds, how much could the money supply change? Why is the answer not \$100? Explain your logic.

B) The multiplier is not really as large as our formula predicts it to be. Explain two economic reasons why it is too large.

5) (18 points) Illustrate ONE of the following events on the MS/MD diagram. Explain the movement(s) of the curve(s). Use M1 for the money supply.

A) Credit cards become more common.

B) Stocks are predicted to make more money.

6) (20 points) Monetarists and the Classical Economists both conclude that the central bank should not do counter-cyclical monetary policy. For ONE of those schools of thought, explain why they do not approve of monetary policy.

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

A) Explain adverse selection and give an example of it in the insurance industry.

B) Explain moral and give an example of it in the insurance industry.

8) (30 points) Illustrate EITHER the event in Part A OR the event in Part B on BOTH the MS/MD diagram and the LRAS/SRAS/AD diagram. Explain why the curve(s) moved as drawn. Use the SAME event for both diagrams.

A) The government buys a \$1 billion plane.

B) The Federal Reserve buys \$100 million worth of bonds.

Assets		Liability and Net Worth	
Cash	10	Checking Accounts	130
Deposits at Fed	5	Savings Accounts	105
Loans	1000	Loans	0
Bonds	200	Misc.	900
Misc.	20	Equity	?