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 of the class which follows yours.

1) (10 points) Answer EITHER Part A OR Part B.
A) Why is it difficult to reduce the government's deficit?
B) Why are the short-run effects of a government deficit different from the long-run effects?

2) (10 points) There are at least three different reasons why economists argue that the government may not want to do fiscal policy to increase the GDP when it is low. Choose ONE of those reasons and explain it.

3) (12 points) Answer EITHER Part A OR Part B.
A) In which category of money, M1 or M2, are savings accounts? Why are they in that category rather than the other category?
B) There are three components to money demand. List TWO of them. For each of them, would M1 or M2 be a better match for that component? Explain your logic.

4) (12 points) Answer EITHER Part A OR Part B.
A) What is *adverse selection*? Give an example of how banks can reduce the problem. Explain how that reduces the problem.
B) What is *moral hazard*? Give an example of how banks can reduce the problem. Explain how that reduces the problem.

5) (16 points) What do you consider to be the biggest problem with the deficit/debt? Explain why that is a big problem. For one other "problem" with the deficit/debt, explain why that "problem" is exaggerated.

6) (16 points) Illustrate EITHER an increase in GDP OR an increase in the price level on the money supply/money demand diagram. Explain why the curve(s) moved as drawn. What happens to the variables on the axis?

7) (24 points) Answer EITHER Part A OR Part B.
A) Illustrate an increase in government spending on the SRAS/LRAS/AD diagram. How would the diagram change if crowding out is a big problem? Illustrate that change. Explain the movement(s) of the curve(s) in each part.
B) Draw an SRAS/LRAS/AD diagram with a high unemployment rate. Explain how you know the unemployment rate is high. Should the Federal Reserve buy or sell bonds? Why did you make that choice? Illustrate that action on the diagram and explain why the curve(s) moved as drawn.