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 *crowding out of investment* OR *direct expenditure offset*, explain how that could cause fiscal policy to be ineffective at changing GDP.

2) (14 points) Answer EITHER Part A OR Part B.
A) Suppose that government spending is $500, transfer payments are given as 350 – 0.1*Y, and tax revenue is 0.2*Y. If GDP is $2500, then how much is the government deficit or surplus? If full-employment level of GDP is $3000, then how much is the full-employment government deficit or surplus? Show all work for both parts and explain your logic.
B) Explain *Ricardian Equivalence*. Do you believe it holds? Why or why not?

3) (16 points) Answer EITHER Part A OR Part B.
A) What happens to M1 and M2 if you transfer $100 from your savings account to your checking account? Explain your logic. What happens to M1 and M2 when you then pay for a $110 textbook with a check? Explain your logic.
B) What are the four properties money should have? For one of them, does M1 or M2 do better with that criteria? Explain your logic.

4) (18 points) Answer EITHER Part A OR Part B.
A) What is meant by moral hazard? Give an example from the insurance industry. What does the insurance industry do to reduce it? Explain how that action reduces the problem.
B) What is meant by adverse selection? Give an example from the banking industry. What does the insurance industry do to reduce it? Explain how that action reduces the problem.

5) (20 points) Answer EITHER Part A OR Part B.
A) We discussed many reasons why the government's deficit and debt are bad for the long-term health of our economy. Which one problem do you feel is the biggest problem at this point in time? Which so called problem do you feel is not really a problem now? Explain your logic for both parts.
B) What two actions would you take to reduce the current deficit if you were part of the Supercommit-tee? Why would you take those actions and how would they reduce the deficit? (The Supercommittee, a.k.a., Joint Select Committee on Deficit Reduction, are a committee of six Senators and six Members of the House which are charged with reducing the government deficit.)

6) (20 points) Answer EITHER Part A OR Part B.
A) Show an increase in exports on the Keynesian Cross (45°) diagram. Explain why the curve moved as drawn. The autonomous expenditure multiplier, a.k.a. the multiplier, defined as the change in GDP cause by a change in an autonomous expenditure (like net exports). It is found in the same manner as the government spending multiplier. Given your diagram, what is the value for the autonomous expenditure multiplier? Explain your logic. If exports go up by $1000, then how much would GDP go up? Explain your logic.
B) Draw the LRAS/SRAS/AD diagram for an economy in an recessionary gap. Show the gap and explain how you know that is a recessionary gap. If the government was to do fiscal policy, then what type of policy should they do? Illustrate the effects of that on the diagram. Explain why the curve(s) moved as drawn.