

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) Answer EITHER Part A OR Part B.

A) We gave four uses of money. Name ONE of the four. Is M1 or M2 better at that use? Explain your logic. (Note that I am **not** asking about the three parts of money demand.)

B) The answers to the homework question about events' affecting M1 and M2 had only one example when M2 changed. Why doesn't M2 change in most cases? What made the one exception different, i.e., why did M2 change the one time?

2) (16 points) Answer EITHER Part A OR Part B.

A) Draw the money supply/money demand diagram. Illustrate the effects of the Federal Reserve's reducing the required reserve ratio. Explain why the curve(s) moved as drawn. What happens to the money supply and the interest rate?

B) Draw the money supply/money demand diagram. Illustrate the effects of the price level going up. Explain why the curve(s) moved as drawn. What happens to the money supply and the interest rate?

3) (16 points) Answer EITHER Part A OR Part B.

A) What is meant by counter-cyclical fiscal policy? What is meant by "lags in fiscal policy"? Explain how the lags may cause counter-cyclical fiscal policy to make the economy more unstable.

B) What is meant by counter-cyclical fiscal policy? What is meant by "Ricardian Equivalence"? Explain how the Ricardian Equivalence may cause counter-cyclical fiscal policy to not impact the economy at all.

4) (18 points) Answer EITHER Part A OR Part B.

A) Crowding out causes one problem in the short run and a different problem in the long run. Explain how the short-run problem occurs. Use the money supply/money demand diagram to explain the step which we could not explain for a long time. Explain why the curve(s) moved as drawn.

B) Crowding out causes one problem in the short run and a different problem in the long run. Explain how the long-run problem occurs. Use the LRAS/SRAS/AD diagram to explain the long-term negative impact of the government debt. Explain why the curve(s) moved as drawn.

5) (18 points) Answer EITHER Part A OR Part B.

A) Give an example of a negative supply shock. Illustrate the effects of it on the LRAS/SRAS/AD diagram. State why the curve(s) moved as drawn. What happens to the price level and GDP?

B) Draw the SRAS/LRAS/AD diagram with the economy in an inflationary gap. State how you know your graph shows an inflationary gap. Illustrate how the economy would get back to equilibrium if the government took no action. Explain why the curve(s) moved as drawn. What happens to the price level and real GDP?

6) (20 points) Answer EITHER Part A OR Part B.

A) What is the problem facing Social Security? What are the two long-term problems which mean the problem will get worse for at least a decade? One of the proposed solutions to the problem is to remove the "means test benefits." How would that reduce the problem? Should that be part of the solution? Explain your logic.

B) What is the problem facing Social Security? What are the two long-term problems which mean the problem will get worse for at least a decade? One of the proposed solutions to the problem is to increase the Social Security tax. How would that reduce the problem? Should that be part of the solution? Explain your logic.