

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 and is scheduled to take 50 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 16-point question should take 8 minutes. I will give a few extra minutes, but probably no later than about 5 minutes, i.e., until the end of the hour.

1) (10 points) For EITHER the event in part A OR the event in part B, determine what happens to M1 and M2. Explain why they change or fail to change.

A) You use a credit card to buy a \$1200 computer.

B) While at the ATM, you remove \$100 cash from your savings account.

2) (14 points) This question refers to the balance sheet below. How much should go in "Stockholders' Equity"? How much excess reserves does this firm have? Show all work and give a one-sentence explanation for each part.

Assets		Liabilities and Net Worth	
Deposits at Fed	100	Demand Deposits	900
Cash in Vault	50	Savings Accounts	400
Loans	1500	Loans	10
Bonds	150	Misc.	500
Misc	200	Stockholders' Equity	???

3) (14 points) Do EITHER part A OR part B.

A) There are four reasons that we hold money. Which reason or reasons for holding money are very weak when inflation is about 1000%? Explain your logic.

B) We say that the central bank wants to know the volume of liquid money. Is that M1 or M2? Why do they want to know the volume of the liquid money and why did you say M1 or M2?

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

A) Draw the Laffer Curve. Explain why it takes that shape and why it is important.

B) What automatic stabilizers exist in our economy? Explain why they stabilize the economy.

5) (22 points) Do EITHER part A OR part B.

A) Collateral can work against both the problems of adverse selection and moral hazard. Explain how it reduces both problems. Make sure you define both problems.

B) The Fed has three tools to affect the money supply. Other than open market operations, state what the other two tools are and how changing them will change the money supply and the money multiplier.

6) (24 points) Do EITHER part A OR part B.

A) Illustrate on the SRAS/LRAS/AD diagram an increase in government spending. Explain why the curve(s) moved as drawn. Show the crowding out and explain why it occurs.

B) Draw an SRAS/LRAS/AD diagram for an economy in a recessionary gap. Explain how you know it is in a recessionary gap. What type of tax change would fix it? Illustrate that tax change and explain why the curve(s) moved as drawn.