

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 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 14-point question should take 7 minutes. I can give some extra time, but not much because of the class which follows yours.

1) Use the balance sheet to the right to answer BOTH parts of this question.

A) (6 points) How much goes in the “?” in the balance sheet? Show all work and briefly explain how you got it.

B) (6 points) How much are the excess reserves? Show all work and briefly explain how you got it.

2) (10 points) For EITHER the event in Part A OR the event in Part B, determine what happens to M1 and M2. Explain why those changed as described.

A) You take \$100 cash out of savings account.

B) You take a car loan for \$5000.

3) (12 points) Answer EITHER Part A OR Part B.

A) Should the government deficit or surplus rise or fall when GDP rises? Why? Is the opposite true for decreases in GDP? Why?

B) Explain the difference between the government deficit and the government debt.

4) (14 points) Answer EITHER Part A OR Part B.

A) What is the money multiplier process? Explain how the discount rate can affect the size of the money multiplier?

B) Illustrate on a balance sheet for a bank, the results of the Fed’s buying a bond from the bank. Briefly state how you determined the entries. What happened to the money supply in that step? How did you get that?

5) (14 points) Answer EITHER Part A OR Part B.

A) The Federal Reserve has considered including part of savings accounts in M1. For example, they might count 40% of the account balance in M1 and the rest in M2. Why might this make sense? When giving your reason, refer to the properties which the items in M1 and M2 have.

B) What is financial intermediation? Why would we want to use a financial intermediary?

6) (16 points) Answer EITHER Part A OR Part B.

A) Use an appropriate graph to explain why lags may mean that fiscal policy should not be used to stabilize the economy.

B) What is Ricardian Equivalence? Do you agree with it? Why or why not?

7) (22 points) Answer EITHER Part A OR Part B.

A) Draw the 45° diagram, a.k.a. the Keynesian cross diagram, and show an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, what do you estimate to be the autonomous expenditure multiplier? Explain your logic.

B) Draw the SRAS/LRAS/AD diagram and show an increase in government spending. Explain why the curve(s) moved as drawn. Since the government spending will cause interest rates to go up, illustrate the effect of the interest rates going up. Explain why the curve(s) moved as drawn and why that changes the size of the government spending multiplier.

Assets		Liabilities and Net Worth	
Cash	100	Demand deposits	2000
Deposits at Fed.	150	Savings accounts	?
Loans	3000	Loans	0
Bonds	500	Other	200
Other	250	Equity	800