

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 150 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) (10 points) Answer EITHER Part A OR Part B using the balance sheet on the right.

A) Why are loans on both sides of the balance sheet? What is the difference between them?

B) How much excess reserves does this bank have? If the money multiplier worked to its fullest extent, then what would be the ultimate change in the money supply? Show all work for both calculations and briefly explain what you are doing.

Assets		Liabilities and Net Worth	
Cash	100	Demand deposits	2000
Deposits at Fed.	150	Savings accounts	950
Loans	3000	Loans	50
Bonds	500	Other	200
Other	250	Equity	800

2) (12 points) Answer EITHER Part A OR Part B.

A) What is the difference between GDP and GNP? Which do you think would be most closely tied to the unemployment rate? Explain your logic.

B) Use a graph to explain why an increase in the tax rate can cause tax revenue to decrease.

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

A) I heard a student say “We should spend everything necessary to save a life.” Morally, he is correct; however, there is an economic problem with this statement. What is it?

B) I firmly believe that every student who enters Bethany College is smart enough to get an A in this course. Why are few of the students in this class getting an A?

4) (14 points) In their song *Capitalism*, Oingo Boingo sings, “There is nothing wrong with capitalism. There is nothing wrong with free enterprise.” Most of the time they are correct. EITHER explain why they are normally correct (Hint: Why is the intersection of supply and demand socially optimal in most cases?) OR use an example to explain why they are not always correct (Hint: What is one of the reasons we need government intervention in the market?).

5) (16 points) Answer EITHER Part A OR Part B.

A) The price of oil has been increasing recently. Illustrate that on the LRAS/SRAS/AD diagram. Explain why the curve(s) moved as drawn. State what will happen to GDP and the price index.

B) Statistics have shown that the marginal propensity to save has been decreasing in the USA. Illustrate that on the 45° diagram, a.k.a. the Keynesian Cross diagram. Explain why the curve(s) moved as drawn.

6) (18 points) Illustrate EITHER the event in Part A OR the event in Part B on the supply and demand an education at Bethany College. Explain your logic. (Obviously, these are unrealistic examples.)

A) The professors get a pay raise.

B) Bubba’s Bison Inn closes.

7) (18 points) Answer EITHER Part A OR Part B.

A) The problem with lags in fiscal policy are also a problem with monetary policy. For TWO of the lags, state what the lag is and determine whether fiscal policy or monetary policy would have a longer lag. Explain your logic.

B) Use the supply and demand for money to explain why no central bank can control both interest rates and the money supply.