

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 10-point question should take 5 minutes. I cannot give extra time because of the class which follows yours.

1) (10 points) Answer EITHER Part A OR Part B.

A) Why should we know the unemployment rate when considering the desirability or lack of desirability of the deficit?

B) What are the automatic stabilizers? Why are they called that?

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

A) Suppose you currently have money in all types of accounts of M1 and M2. If interest rates increase, how would you reallocate your money? Name one part of the money supply you would hold less of and one part you would hold more of. Why would you move the money in that direction? What happens to M1 and M2? Explain your logic.

B) Money must be a good medium of exchange. Would M1 or M2 be better for that? Why? Money must also store wealth well. Would M1 or M2 be better for that? Why?

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

A) What is the difference between the government deficit and the government debt?

B) Normally, the properties of money called *unit of account* and *medium of exchange* are done together. Why are they normally treated as the same?

4) (14 points each) For TWO of the arguments below that say the government deficit and debt are bad, explain the argument and then determine if it is a valid argument. Explain your logic.

A) Crowding out

B) Future generations must pay the debt

C) We owe foreigners the money.

5) (16 points) For EITHER *moral hazard* OR *adverse selection*, define the term, give an example of it in banking, and explain one way banks try to avoid it.

6) (22 points) Answer EITHER Part A OR Part B.

A) Currently, the unemployment rate in the USA is 4.8%. Is that too high or too low? (Do not choose "correct.") Draw the LRAS/SRAS/AD diagram which shows this situation. Explain how you know the graph shows that unemployment rate. What type of fiscal policy should be done? Illustrate that on the graph. Explain why your policy moved the curve(s) as drawn.

B) Draw an LRAS/SRAS/AD diagram which starts with a high unemployment rate. Explain how you know the graph shows a high unemployment rate. What type of fiscal policy should be done? Illustrate that on the graph. Explain why your policy moved the curve(s) as drawn. If there is crowding out, what else would happen to the diagram? Explain your logic.