

This was for Seniors who are taking comps, so covers less material.

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 some students have a class after your class.

- 1) (8 points) What is the difference between the government's deficit and their debt?
- 2) (10 points) Answer EITHER Part A OR Part B.
 - A) Why is it important to know why the deficit is so large?
 - B) Why does Paul O'Neill feel the US government owes about five times what the Treasury says is owed?
- 3) (14 points) Answer EITHER Part A OR Part B.
 - A) If you were to reduce the government's deficit, how would you do it? Explain why you chose that method.
 - B) How are the government's deficit and the trade deficit related? Explain your logic.
- 4) (14 points) For EITHER Ricardian Equivalence OR lags, explain why that is an argument for not doing fiscal policy.
- 5) (16 points) For EITHER of the following "problems" that the deficit and debt cause, explain what problem is. Then determine the extent to which the argument is valid. Explain your logic.
 - A) Future generations will have to pay the debt.
 - B) It causes crowding out.
- 6) (18 points) Answer EITHER Part A OR Part B.
 - A) Suppose that government spending is $G = 1000$. The tax revenue is $T = -20 + 0.2 \cdot Y$. The current GDP is 5200 and the full-employment level of GDP is 5000. What are the government deficit/surplus and the full-employment government deficit/surplus? Show all work. Do you think this government is doing good fiscal policy? Explain your logic. (Yes, it is a negative sign in front of the 20 in $T = . . .$)
 - B) What are the automatic stabilizers? Why are they called that? What is the economic reason I put a negative sign in front of the 20 in the equation in Part A?
- 7) (20 points) Answer EITHER Part A OR Part B.
 - A) Illustrate an **inflationary gap** on the SRAS/LRAS/AD diagram. State how you know it is an inflationary gap. What fiscal policy should the government do if it was to solve the problem? Explain your logic and illustrate it on the diagram. Explain why the curve(s) moved as drawn. What happened to the price level and the GDP?
 - B) Illustrate a **deflationary gap** on the SRAS/LRAS/AD diagram. State how you know it is a deflationary gap. What fiscal policy should the government do if it was to solve the problem? Explain your logic and illustrate it on the diagram. Explain why the curve(s) moved as drawn. What happened to the price level and the GDP?