

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 150 points (to be scaled up to 210 points) and is scheduled to take 75 minutes. Therefore, expect to spend 1 minute for every 2 points. For example, a 12-point question should take 6 minutes. I cannot give extra time because some students have a class after your class.

- 1) (12 points) For EITHER open market operations OR required reserve ratio, explain how the Fed could use it to decrease the money supply. Explain why it would have that effect.
- 2) (12 points) Draw EITHER the AD curve OR the Classical SRAS curve. Explain why it takes its shape.
- 3) (12 points) Answer EITHER Part A OR Part B.
 - A) The current unemployment rate in the USA is 3.8%. What is the best fiscal policy for this situation? Explain why that is the best policy.
<https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm>
 - B) What are two of the three automatic stabilizers? Explain why they are called that.
- 4) (14 points) For EITHER lags OR the Keynesian liquidity trap, explain why it might mean that counter-cyclical monetary policy might either not work or have bad effects. Use an appropriate graph in your explanation.
- 5) (16 points) For EITHER the argument in Part A OR the argument in Part B, explain why it may make expansionary fiscal policy less effective. Do you think it is a strong argument? Explain your logic.
 - A) Direct expenditure offset
 - B) Lags in fiscal policy
- 6) (16 points) For EITHER the argument in Part A OR the argument in Part B, explain why it means the large US government debt is a problem for the future. Do you think it is a strong argument? Explain your logic.
 - A) Crowding out
 - B) When we pay off the debt, it will hurt the economy.
- 7) (16 points) Answer EITHER Part A OR Part B.
 - A) What are the four uses of money? For one of them, does M1 or M2 do a better job? Explain your logic.
 - B) What is adverse selection? Explain why that causes us to use financial intermediaries.
- 8) (16 points) Answer EITHER Part A OR Part B.
 - A) Draw the MS/MD diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to the interest rate and the money supply?
 - B) Draw the MS/MD diagram. Illustrate the effects of prices going up. Explain why the curve(s) moved as drawn. What happens to the interest rate and the money supply?

9) (16 points) Answer EITHER Part A OR Part B.

A) Explain the difference between gross public debt, net public debt, and the debt Paul O'Neill discussed. Which one is most closely related to crowding out? Explain your logic.

B) Explain the difference between gross public debt, net public debt, and the debt Paul O'Neill discussed. Which one is most closely related to future problems with the budget? Explain your logic.

10) (20 points) Answer EITHER Part A OR Part B.

A) Draw an LRAS/SRAS/AD diagram for a country in an inflationary gap. Explain how you know it is an inflationary gap. If the government does nothing, then what will bring the economy back to full employment? Illustrate the effects of that on the diagram. Explain why the curve(s) moved as drawn. What happens to GDP, the price level, and the unemployment rate?

B) Draw an LRAS/SRAS/AD diagram for a country in a recessionary gap. Explain how you know it is a recessionary gap. Suppose a new technology greatly increases the productivity of most firms. Illustrate the effects of that technology on the diagram. Explain why the curve(s) moved as drawn. What happens to GDP, the price level, and the unemployment rate?