

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

A) Explain how *cost push inflation* gets its name.

B) Explain what might cause a *demand shock* to occur.

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

A) There are three automatic stabilizers. Tell me what one of them is and why it is called an automatic stabilizer.

B) Even though the FDIC is not considered an automatic stabilizer. What is it? Explain how it prevents the economy from collapsing.

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

A) Money should be a good store of value. What does that mean? Is M1 or M2 better at that? Explain your logic.

B) What is the Federal Reserve? What are two of the jobs it does?

4) (12 points) Answer EITHER Part A OR Part B.

A) When we estimated the size of the government spending multiplier, what was the first value we came up with? If the government wanted to increase GDP by \$1000, then how much more would they have to spend? How did you reach that conclusion?

B) When we estimated the size of the government spending multiplier, we implicitly made a series of assumptions. What did we assume about taxes? If we relax that assumption, what happens to the size of the government spending multiplier? Explain your logic.

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

A) We said that *direct expenditure offset* may make counter-cyclical fiscal policy either less effective or counter-productive. Explain why this is true. Do you believe it is a problem? Explain your logic.

B) We said that *crowding out* may make counter-cyclical fiscal policy either less effective or counter-productive. Explain why this is true. Do you believe it is a problem? Explain your logic.

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

A) What is the Keynesian Liquidity trap? Explain why it may make counter-cyclical monetary policy ineffective.

B) Prove that the Fed cannot control both the money supply and the interest rates.

7) (16 points) Answer EITHER Part A OR Part B.

A) Draw the MS/MD diagram. Illustrate the effects of the Congress spending more. Explain why the curve(s) moved as drawn. What happens to the quantity of money and the interest rate?

B) One of the reasons that the AD curve slopes down is the *interest rate effect*. Use the MS/MD diagram to explain that reason why the AD curve slopes down.

8) (18 points) Answer EITHER Part A OR Part B.

A) In 2022, the price of oil has greatly increased. Draw the LRAS/SRAS/AD diagram and illustrate the

effects of the increase in the price of oil. Explain why the curve(s) moved as drawn. What happens to the inflation rate, unemployment rate, and GDP?

B) The current unemployment rate is 3.6%. Draw the LRAS/SRAS/AD diagram to show that unemployment rate. State how your graph shows 3.6%. If the government does nothing, what will happen to bring us back to equilibrium? Explain why the curve(s) moved as drawn. What happens to the inflation rate, unemployment rate, and GDP?

<https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm>

9) (18 points) Answer EITHER Part A OR Part B.

A) Draw the LRAS/SRAS/AD diagram. Illustrate the effects an improved technology. Explain why the curve(s) moved as drawn. What happens to the GDP, unemployment rate, and inflation rate?

B) Draw the LRAS/SRAS/AD diagram. Illustrate the effects of a tax cut. Explain why the curve(s) moved as drawn. What happens to the GDP, unemployment rate, and inflation rate?

10) (20 points) For EITHER the problem with the debt listed in Part A or the problem with the debt listed in Part B, explain what the issue is. Then tell me if that is caused by net public debt, gross public debt, or Paul O'Neill's debt. Explain your logic. Is that problem a problem or not? Explain your logic.

A) Paying off the debt will hurt future generations

B) Debt to foreigners