

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 12-point question should take 6 minutes. I can give extra time but not a lot.

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

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

B) About 15 years ago, the [detergent Tide was being used as money by some people](#). Which of the four qualities of money does Tide do a bad job at? Explain your logic. (I think it does a bad job for all four.)

2) (14 points) Answer EITHER Part A OR Part B.

A) What is the difference between gross national debt and net national debt. Which is more likely to cause long-term problems in the economy? Explain your logic.

B) Trump is correct, the long-term growth of GDP will be affected because of the high debt. Explain whether that is a big problem with the government debt, a small problem, or not a problem. Make sure you explain how the growth rate is affected.

3) (14 points) Answer EITHER Part A OR Part B.

A) Suppose $G = 1000$, transfers = $1000 - .1 * GDP$, tax revenue = $.2 * GDP$ and interest payments = 200. If $GDP = 7000$, then how much is the government budget deficit or surplus? If full employment GDP is 8000, how much is the full employment budget deficit or surplus? Make sure you state whether your numbers are deficit or surplus. Show all work and state how you did the calculations.

B) Explain the term “twin deficits” and how one causes the other.

4) (16 points) Answer EITHER Part A OR Part B.

A) Explain how *collateral* reduces *moral hazard* in loans. Make sure you define both terms.

A) Explain how *collateral* reduces *adverse selection* in loans. Make sure you define both terms.

5) (18 points) Answer EITHER Part A OR Part B.

A) Use MS/MD diagram to explain why the Fed cannot control both interest rates and the money supply.

B) Draw the MS/MD diagram. Explain why the MD curve looks as I drew it.

6) (28 points) Answer EITHER Part A OR PART B.

A) Draw the SRAS/LRAS/AD diagram and the MS/MD diagram. The current inflation rate is too high. Should the Fed be buying or selling bonds? Illustrate the effects of the Fed's buying or selling bonds (whichever is appropriate). Explain why the curves moved as drawn. What happens to interest rates, GDP, inflation, and unemployment rate?

B) Draw the SRAS/LRAS/AD diagram for a country in a recessionary gap, and the MS/MD diagram. What is the best monetary policy? Illustrate that on the diagrams. Explain why the curve(s) moved as drawn. What happens to interest rates, GDP, inflation, and the unemployment rate?