

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 cannot give extra time some students have a class after your class.

1) (12 points) Answer EITHER Part A OR Part B.

A) Very few events change MZM without changing M2. Why is that true? Give an example of an event which does change MZM without changing M2.

B) Does M1, MZM, or M2 do a better job as a store of value? Explain your logic.

2) (14 points) For EITHER the item in Part A OR the item in Part B, explain how it will impact expansionary fiscal policy. Do you think this is a common problem? Explain your logic.

A) direct expenditure offset

B) Ricardian equivalence

3) (16 points) Answer EITHER Part A OR Part B.

A) 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.

B) So far this fiscal year (starting October 1st), [government spending was \\$1900 billion, transfer payments were \\$1200 billion, interest was \\$500 billion, and tax revenue was \\$2300 billion](#). Calculate the actual federal deficit and the primary federal deficit. Show all work and briefly state what you did. During that whole time, the [unemployment rate has been between 4.0% and 4.2%](#). Is the full-employment budget deficit larger or smaller than you calculated? Explain your logic. (All budget numbers were rounded to the nearest \$100 billion.)

4) (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.

5) (20 points) Answer EITHER Part A OR part B.

A) Draw the LRAS/SRAS/AD diagram for an economy in an inflationary gap. State how you know it is in an inflationary gap. What is the best fiscal policy? Illustrate that on the diagram. Explain why the curve(s) moved as drawn. What happens to GDP, inflation, and the unemployment rate?

B) Draw the LRAS/SRAS/AD diagram for an economy in a recessionary gap. State how you know it is in a recessionary gap. What is the best monetary policy? Illustrate that on the diagram. Explain why the curve(s) moved as drawn. What happens to GDP, inflation, and the unemployment rate?

6) (20 points) Answer EITHER Part A OR Part B.

A) According to [this webpage](#), the unemployment rate for late 2009 and early 2010 was just over 10%. Illustrate that on the LRAS/SRAS/AD diagram. State how you know the diagram has 10% unemployment. If the government did nothing, illustrate how the economy would get back to full employment. Explain why the curve(s) moved as drawn. What happens to GDP, inflation, and the unemployment rate?

B) Draw the LRAS/SRAS/AD diagram. Illustrate the effects of an increase in the money supply.

Explain why the curve(s) moved as drawn. How would the diagram be different if the economy was in a Keynesian Liquidity Trap? Explain your logic.