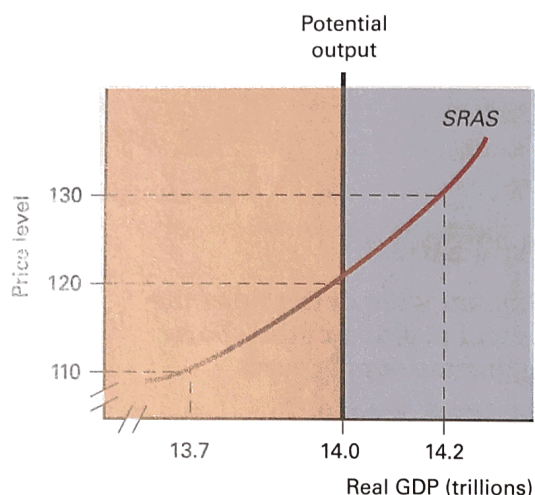


10-2 Describe the market forces that push the economy toward its potential output in the long run

3. (*Expansionary and Recessional Gaps*) Answer questions a through f on the basis of the following graph:



- If the actual price level exceeds the expected price level reflected in long-term contracts, real GDP equals _____ and the actual price level equals _____ in the short run.
 - The situation described in part (a) results in a(n) _____ gap equal to _____.
 - If the actual price level is lower than the expected price level reflected in long-term contracts, real GDP equals _____ and the actual price level equals _____ in the short run.
 - The situation described in part (c) results in a(n) _____ gap equal to _____.
 - If the actual price level equals the expected price level reflected in long-term contracts, real GDP equals _____ and the actual price level equals _____ in the short run.
 - The situation described in part (e) results in a(n) _____ gap equal to _____.
4. (*Long-Run Adjustment*) The ability of the economy to eliminate any imbalances between actual and potential output is sometimes called self-correction. Using an aggregate supply and aggregate demand diagram, show why this self-correction process involves only temporary periods of inflation or deflation.

10-3 Explain why shifts of the aggregate demand curve change the price level in the long run but do not change potential output

5. (*Changes in Aggregate Supply*) List three factors that can change the economy's potential output. What is the impact of shifts of the aggregate demand curve on potential output? Illustrate your answers with a diagram.

10-4 Summarize what can shift an economy's potential output in the long run

6. (*Supply Shocks*) Give an example of an adverse supply shock and illustrate graphically. Now do the same for a beneficial supply shock.

CHAPTER 11

11-1 Describe the discretionary fiscal policies to close a recessionary gap and an expansionary gap

- (*Fiscal Policy*) Define *fiscal policy*. Determine whether each of the following, other factors held constant, would lead to an increase, a decrease, or no change in the level of real GDP demanded:
 - A decrease in government purchases
 - An increase in net taxes
 - A reduction in transfer payments
 - A decrease in the marginal propensity to consume
- (*Recessionary Gap*) What is a recessionary gap? What fiscal policy might close that gap? Show with a graph.
- (*Expansionary Gap*) What is an expansionary gap? What fiscal policy might close that gap? Show with a graph.
- (*Changes in Government Purchases*) Assume that government purchases decrease by \$10 billion, with other factors held constant, including the price level. Calculate the change in the level of real GDP demanded for each of the following values of the MPC. Then, calculate the change if the government, instead of reducing its purchases, increased autonomous net taxes by \$10 billion.
 - 0.9
 - 0.8
 - 0.75
 - 0.6
- (*Fiscal Multipliers*) Explain the difference between the government purchases multiplier and the net tax multiplier. If the MPC falls, what happens to the tax multiplier?
- (*Multipliers*) Suppose investment, in addition to having an autonomous component, also has a component that varies directly with the level of real GDP. How would this affect the size of the spending multiplier?
- (*Fiscal Policy*) Chapter 11 shows that increased government purchases, with taxes held constant, can eliminate a recessionary gap. How could a tax cut achieve the same result?
- (*Fiscal Policy with an Expansionary Gap*) Using the aggregate demand–aggregate supply model, illustrate an economy with an expansionary gap. If the government is to close the gap by changing government purchases, should it increase or decrease those purchases? In the long run, what happens to the level of real GDP as a result of government intervention? What happens to the price level? Illustrate this on an *AD–AS* diagram, assuming that the government changes its purchases by exactly the amount necessary to close the gap.

11-2 Summarize fiscal policy from the Great Depression to stagflation

9. (*Evolution of Fiscal Policy*) What did classical economists assume about the flexibility of prices, wages, and interest rates? What did this assumption imply about the self-correcting tendencies in an economy in recession? What disagreements did Keynes have with classical economists?

10. *(Fiscal Policy)* Why or why not was fiscal policy effective when the U.S. economy was experiencing stagflation during the 1970s?

11-3 Identify some reasons why discretionary fiscal policy may not work very well

11. *(Fiscal Policy Effectiveness)* Determine whether each of the following would make fiscal policy more effective or less effective:
- A decrease in the marginal propensity to consume
 - Shorter lags in the effect of fiscal policy
 - Consumers suddenly becoming more concerned about permanent income than about current income
 - More accurate measurement of the natural rate of unemployment

11-4 Summarize fiscal policy from 1980 to the present and describe the most significant event during that period and the fiscal policy response

12. *(Fiscal Policy During the Great Recession)* Using the aggregate demand–aggregate supply model, illustrate what President Obama was trying to accomplish with the \$831 billion stimulus program. What were some costs and benefits of this program?

CHAPTER 12

12-1 Summarize how federal spending priorities have changed since the 1960s

- (Changing Budget Priorities)* What spending category claimed the largest share of federal outlays during the 1960s? How about during the most recent decade?
- (The Federal Budget Process)* Why does the budget require a forecast of the economy? Under what circumstances would actual government spending and tax revenue fail to match the budget as approved?

12-2 Explain why the federal budget has been in deficit in most years since the Great Depression

- (Budget Philosophies)* Explain the differences among an annually balanced budget, a cyclically balanced budget, and functional finance. How does each affect economic fluctuations?
- (Chronic Deficits)* Why has the federal budget been in deficit in all but 14 years since 1929?

12-3 Outline what has happened to the federal debt in recent decades and how it compares with debt levels in other countries

- (Federal Debt)* What has happened to the federal debt since 2008 as measured relative to GDP?
- (Net Public Debt)* What's the level of net public debt (for federal, state, and local governments) relative to U.S. GDP? How does the U.S. measure compare with that of other major economies?
- (Debt Measures)* What's the difference between gross federal debt and federal debt held by the public?

- (The National Debt)* Try the following exercises to better understand how the national debt is related to the government's budget deficit.
 - Assume that the gross national debt initially is equal to \$3 trillion and the federal government then runs a deficit of \$300 billion.
 - What is the new level of gross national debt?
 - If 100 percent of the deficit is financed by the sale of securities to federal agencies, what happens to the amount of debt held by the public? What happens to the level of gross debt?
 - If GDP increased by 5 percent in the same year that the deficit is run, what happens to gross debt as a percentage of GDP? What happens to the level of debt held by the public as a percentage of GDP?
 - Now suppose that the gross national debt initially is equal to \$2.5 trillion and the federal government then runs a deficit of \$100 billion.
 - What is the new level of gross national debt?
 - If 100 percent of this deficit is financed by the sale of securities to the public, what happens to the level of debt held by the public? What happens to the level of gross debt?
 - If GDP increases by 6 percent in the same year as the deficit is run, what happens to gross debt as a percentage of GDP? What happens to the level of debt held by the public as a percentage of GDP?

12-4 Describe how a giant federal debt could have a negative impact on the economy

- (Crowding Out and Capital Formation)* In earlier chapters, we've seen that the government can try to increase GDP in the short run by running a budget deficit. What are some longterm effects of deficit spending?
- (Sustainability of Federal Debt)* Are large federal deficits and a growing federal debt sustainable? What can be learned from the experiences of other countries?

CHAPTER 13

13-1 Identify three functions of money and six qualities of the ideal money

- (Functions of Money)* What are three functions of money?
- (Ideal Money)* What are six qualities of the ideal money?
- (Origins of Banking)* Discuss the various ways in which London goldsmiths functioned as early banks.
- (Types of Money)* Complete each of the following sentences:
 - A product that serves both as money and as a commodity is _____.
 - Most coins and paper money circulating in the United States have face values that exceed the value of the materials from which they are made. Therefore, they are forms of _____.
 - If the government declares that creditors must accept a form of money as payment for debts, the money becomes _____.