

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?

8. *(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 _____.

- d. A common unit for measuring the value of every good or service in the economy is known as a(n) _____.
- (*Fiat Money*) Most economists believe that the better fiat money serves as a store of value, the more acceptable it is. What does this statement mean? How could people lose faith in money?
 - (*The Value of Money*) When the value of money was based on its gold content, new discoveries of gold were frequently followed by periods of inflation. Explain.

13-2 Explain what is meant by a fractional reserve banking system

- (*Depository Institutions*) What is a depository institution, and what types of depository institutions are found in the United States? How do they act as intermediaries between savers and borrowers? Why do they play this role?
- (*Depository Institutions*) Explain why a bank typically holds as reserves only a fraction of its deposit liabilities? In light of this arrangement, why is it important that depositors have confidence in their bank's health?

13-3 Describe the Fed, summarize its two mandated objectives, and outline some of its other goals

- (*Federal Reserve System*) What are the main powers and responsibilities of the Federal Reserve System? What are its two mandates and some of its other goals?

13-4 Describe subprime mortgages and the role they played in the financial crisis of 2008

- (*Subprime Mortgages*) What are subprime mortgages, and what role did they play in the financial crisis of 2008?
- (*Bank Deregulation*) Some economists argue that deregulating the interest rates that could be paid on deposits combined with deposit insurance led to the insolvency of many depository institutions during the 1980s. On what basis do they make such an argument?

CHAPTER 14

14-1 Interpret why using a debit card is like using cash, but using a credit card is not

- (*Credit vs. Debit Cards*) Explain why using a debit card is just like using cash, while using a credit card is different.
- (*Monetary Aggregates*) Calculate M1 and M2 using the following information:

| | |
|--|---------------|
| Large-denomination time deposits | \$304 billion |
| Currency and coin held by the non-banking public | \$438 billion |
| Checkable deposits | \$509 billion |
| Small-denomination time deposits | \$198 billion |
| Traveler's checks | \$18 billion |
| Savings deposits | \$326 billion |
| Money market mutual fund accounts | \$637 billion |

14-2 Explain why a bank is in a better position to lend your savings than you are

- (*Bank Expertise*) Why are banks in a better position to make loans than would be a typical saver? Describe a bank's expertise in this area.
- (*Reserve Accounts*) Suppose that a bank's customer deposits \$4,000 in her checking account. The required reserve ratio is 0.25. What are the required reserves on this new deposit? What is the largest loan that the bank can make on the basis of the new deposit? If the bank chooses to hold reserves of \$3,000 on the new deposit, what are the excess reserves on the deposit?

14-3 Describe how banks create money

- (*Money Creation*) Suppose Bank A, which faces a reserve requirement of 10 percent, receives a \$1,000 cash deposit from a customer.
 - Assuming that it wishes to hold no excess reserves, determine how much the bank should lend. Show your answer on Bank A's balance sheet.
 - Assuming that the loan shown in Bank A's balance sheet is redeposited in Bank B, show the changes in Bank B's balance sheet if it lends out the maximum possible.
 - Repeat this process for three additional banks: C, D, and E.
 - Using the simple money multiplier, calculate the total change in the money supply resulting from the \$1,000 initial deposit.
 - Assume Banks A, B, C, D, and E each wish to hold 5 percent excess reserves. How would holding this level of excess reserves affect the total change in the money supply?
- (*Money Multiplier*) Suppose that the Federal Reserve lowers the required reserve ratio from 0.10 to 0.05. How does this affect the simple money multiplier, assuming that excess reserves are held to zero and there are no currency leakages? What are the money multipliers for required reserve ratios of 0.15 and 0.20?
- (*Money Creation*) Show how each of the following would initially affect a bank's assets and liabilities.
 - Someone makes a \$10,000 deposit into a checking account.
 - A bank makes a loan of \$1,000 by establishing a checking account for \$1,000.
 - The loan described in part (b) is spent.
 - A bank must write off a loan because the borrower defaults.
- (*Money Creation*) Show how each of the following *initially* affects bank assets, liabilities, and reserves. Do *not* include the results of bank behavior resulting from the Fed's action. Assume a required reserve ratio of 0.05.
 - The Fed purchases \$10 million worth of U.S. government bonds from a bank.
 - The Fed loans \$5 million to a bank.
 - The Fed raises the required reserve ratio to 0.10.

14-4 Summarize the Fed's tools of monetary policy

- (*Monetary Tools*) What tools does the Fed have to pursue monetary policy. Which tool does it use the most?

9. (*Monetary Control*) Suppose the money supply is currently \$500 billion and the Fed wishes to increase it by \$100 billion.
 - a. Given a required reserve ratio of 0.25, what should it do?
 - b. If it decided to change the money supply by changing the required reserve ratio, what change should it make? Why may the Fed be reluctant to change the reserve requirement?

CHAPTER 15

15-1 Explain how the demand and supply of money determine the market interest rate

1. (*Money Demand*) Suppose that you never carry cash. Your pay-check of \$1,000 per month is deposited directly into your checking account, and you spend your money at a constant rate so that at the end of each month your checking account balance is zero.
 - a. What is your average money balance during the pay period?
 - b. How would each of the following changes affect your average monthly balance?
 - i. You are paid \$500 twice monthly rather than \$1,000 each month.
 - ii. You are uncertain about your total spending each month.
 - iii. You spend a lot at the beginning of the month (e.g., for rent) and little at the end of the month.
 - iv. Your monthly income increases.
2. (*Market Interest Rate*) With a diagram, show how the supply of money and the demand for money determine the rate of interest? Explain the shapes of the supply curve and the demand curve.

15-2 Outline the steps between an increase in the money supply and an increase in equilibrium output

3. (*Money and Aggregate Demand*) Would each of the following increase, decrease, or have no impact on the ability of open-market operations to affect aggregate demand? Explain your answer.
 - a. Investment demand becomes less sensitive to changes in the interest rate.
 - b. The marginal propensity to consume rises.
 - c. The money multiplier rises.
 - d. Banks decide to hold additional excess reserves.
 - e. The demand for money becomes more sensitive to changes in the interest rate.
4. (*Monetary Policy and Aggregate Supply*) Assume that the economy is initially in long-run equilibrium. Using an *AD-AS* diagram, illustrate and explain the short-run and long-run impacts of an increase in the money supply.
5. (*Monetary Policy and an Expansionary Gap*) Suppose the Fed wishes to use monetary policy to close an expansionary gap.
 - a. Should the Fed increase or decrease the money supply?
 - b. If the Fed uses open-market operations, should it buy or sell government securities?
 - c. Determine whether each of the following increases, decreases, or remains unchanged in the short run: the market interest rate, the quantity of money demanded, investment spending, aggregate demand, potential output, the price level, and equilibrium real GDP.

15-3 Describe the relevance of velocity's stability on monetary policy

6. (*Equation of Exchange*) Calculate the velocity of money if real GDP is 3,000 units, the average price level is \$4 per unit, and the quantity of money in the economy is \$1,500. What happens to velocity if the average price level drops to \$3 per unit? What happens to velocity if the average price level remains at \$4 per unit but the money supply rises to \$2,000? What happens to velocity if the average price level falls to \$2 per unit, the money supply is \$2,000, and real GDP is 4,000 units?
7. (*Quantity Theory of Money*) What basic assumption about the velocity of money transforms the equation of exchange into the quantity theory of money? Also:
 - a. According to the quantity theory, what will happen to nominal GDP if the money supply increases by 5 percent and velocity does not change?
 - b. What will happen to nominal GDP if, instead, the money supply decreases by 8 percent and velocity does not change?
 - c. What will happen to nominal GDP if, instead, the money supply increases by 5 percent and velocity decreases by 5 percent?
 - d. What happens to the price level in the short run in each of these three situations?

15-4 Summarize the specific policies the Fed pursued during and after the Great Recession

8. (*Great Recession*) How did the Fed try to bring the economy back during and after the Great Recession? What specific policies did it pursue?
9. (*Money Supply Versus Interest Rate Targets*) Assume that the economy's real GDP is growing.
 - a. What will happen to money demand over time?
 - b. If the Fed leaves the money supply unchanged, what will happen to the interest rate over time?
 - c. If the Fed changes the money supply to match the change in money demand, what will happen to the interest rate over time?
 - d. What would be the effect of the policy described in part (c) on the economy's stability over the business cycle?
10. (*Quantitative Easing*) What's the difference between ordinary open-market purchases and quantitative easing?
11. (*Quantitative Easing*) Because of quantitative easing, the Fed purchased more than two trillion dollars of financial assets. Why did the Fed do this? How are these purchases reflected on the Fed's balance sheet? And why hasn't this increased the rate of inflation, at least not as of December 2013?

CHAPTER 16

16-1 Outline the difference between active policy and passive policy and explain how the two approaches differ in their assumptions about how well the economy works on its own

1. (*Active Versus Passive Policy*) Discuss the role each of the following plays in the debate between the active and passive approaches:
 - a. The speed of adjustment of the nominal wage
 - b. The speed of adjustment of expectations about inflation