c. The existence of lags in policy creation and implementation
d. Variability in the natural rate of unemployment over time

2. *(Problems with Active Policy)* Use an *AD–AS* diagram to illustrate and explain the short-run and long-run effects on the economy of the following situation: Both the natural rate of unemployment and the actual rate of unemployment are 5 percent. However, the government believes that the natural rate of unemployment is 6 percent and that the economy is overheating. Therefore, it introduces a policy to reduce aggregate demand.

16-2 Describe how expectations can influence the effectiveness of discretionary policy

3. *(Rational Expectations)* Using an *AD–AS* diagram, illustrate the short-run effects on prices, output, and employment of an increase in the money supply that is correctly anticipated by the public. Assume that the economy is initially at potential output.

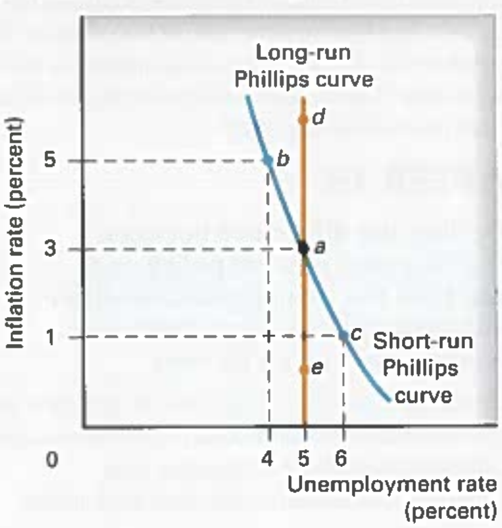
16-3 Summarize why some economists prefer that policy be shaped by predictable rules rather than by the discretion of policy makers

4. *(Policy Lags)* What lag in discretionary policy is described in each of the following statements? Why do long lags make discretionary policy less effective?
   a. The time from when the government determines that the economy is in recession until a tax cut is approved to reduce unemployment
   b. The time from when the money supply is increased until the resulting effect on the economy is felt
   c. The time from the start of a recession until the government identifies the existence and severity of the recession
   d. The time from when the Fed decides to reduce the money supply until the money supply actually declines

16-4 Explain the shape of the short-run Phillips curve and the long-run Phillips curve

5. *(Long-Run Phillips Curve)* Suppose the economy is at point *d* on the long-run Phillips curve shown in the accompanying exhibit. If that inflation rate is unacceptably high, how can policy makers get the inflation rate down? Would rational expectations help or hinder their efforts?

Phillips Curves in the Short Run and Long Run



CHAPTER 17

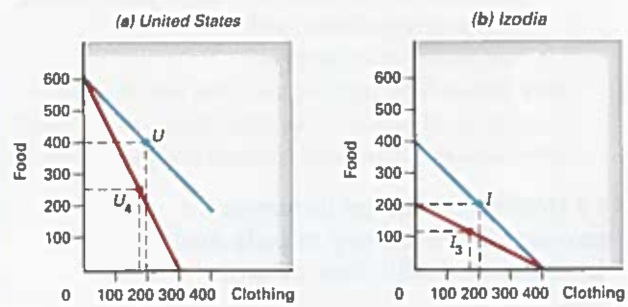
17-1 Outline the gains from trade, and explain why countries might still decide to trade even if no country had a comparative advantage

1. *(Trade Without Comparative Advantage)* Even if neither country had a comparative advantage, why might these countries still experience gains from trade?

2. *(Comparative Advantage)* Suppose that each U.S. worker can produce 8 units of food or 2 units of clothing daily. In Fredonia, which has the same number of workers, each worker can produce 7 units of food or 1 unit of clothing daily. Why does the United States have an absolute advantage in both goods? Which country enjoys a comparative advantage in food? Why?

3. *(Comparative Advantage)* The consumption possibilities frontiers shown by the blue lines in the following exhibit assume terms of trade of 1 unit of clothing for 1 unit of food. What would the consumption possibilities frontiers look like if the terms of trade were 1 unit of clothing for 2 units of food?

Production (and Consumption) Possibility Frontiers with Trade (millions of units per day)



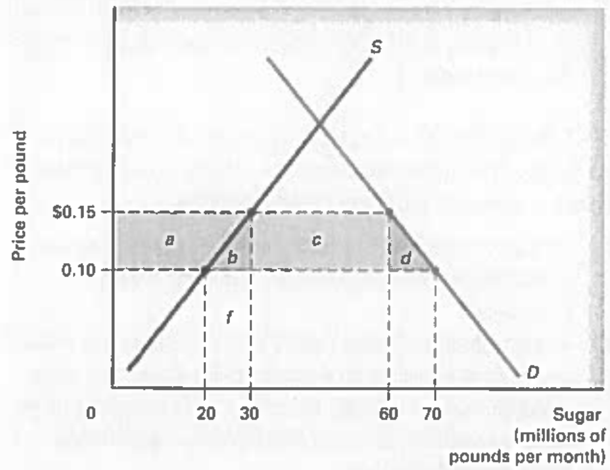
4. *(Reasons for International Specialization)* What determines which goods a country should produce and export?

17-2 Explain how trade restrictions harm an economy, and why they persist

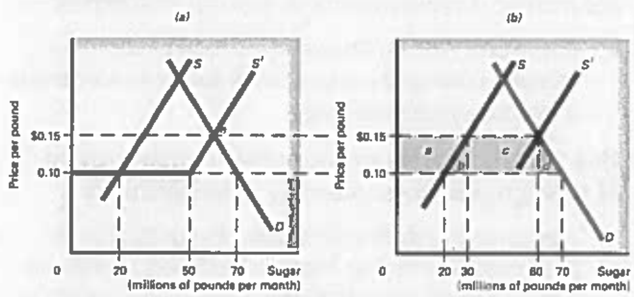
5. *(Import Quotas)* How low must a quota be to have an impact on trade? Using a demand-and-supply diagram, illustrate and explain the net welfare loss from imposing such a quota. Under what circumstances would the net welfare loss from an import quota exceed the net welfare loss from an equivalent tariff (one that results in the same price and import level as the quota)?

6. *(Trade Restrictions)* Suppose that the world price for steel is below the U.S. domestic price, but the government requires that all steel used in the United States be domestically produced.
   a. Use a diagram like the one that follows to show the gains and losses from such a policy.
   b. How could you estimate the net welfare loss (deadweight loss) from such a diagram?
   c. What response to such a policy would you expect from industries (like automobile producers) that use U.S. steel?
   d. What government revenues are generated by this policy?

Effect of a Tariff



Effect of a Quota



7. *(Trade Restrictions)* The previous three graphs show net losses to the economy of a country that imposes tariffs or quotas on imported sugar. What kinds of gains and losses would occur in the economies of countries that export sugar?

17-3 Identify international efforts to reduce trade barriers

8. *(The World Trade Organization)* What is the World Trade Organization (WTO) and how does it help foster multilateral trade? (Check the WTO Website at http://www.wto.org/.)

17-4 Summarize five arguments often used to justify trade restrictions, and describe some unintended consequences of protecting certain industries from international competition

9. *(Arguments for Trade Restrictions)* Explain the national defense, declining industries, and infant industry arguments for protecting a domestic industry from international competition.
10. *(Arguments for Trade Restrictions)* Firms hurt by lower priced imports typically argue that restricting trade will save U.S. jobs. What's wrong with this argument? Are there ever any reasons to support such trade restrictions?

CHAPTER 18

18-1 Summarize the major accounts in the balance of trade, and explain how they balance out

1. *(Balance of Payments)* The following are hypothetical data for the U.S. balance of payments. Use the data to calculate each of the following:
   a. Merchandise trade balance
   b. Balance on goods and services
   c. Balance on current account
   d. Financial account balance
   e. Statistical discrepancy

	Billions of Dollars
Merchandise exports	350.0
Merchandise imports	2,425.0
Service exports	2,145
Service imports	170
Net income and net transfers	221.5
Change in U.S.-owned assets abroad	245.0
Change in foreign-owned assets in U.S.	100.0

2. *(Balance of Payments)* Explain where in the U.S. balance of payments an entry would be recorded for each of the following:
   a. A Hong Kong financier buys some U.S. corporate stock.
   b. A U.S. tourist in Paris buys some perfume to take home.
   c. A Japanese company sells machinery to a pineapple company in Hawaii.
   d. U.S. farmers gave food to starving children in Ethiopia.
   e. The U.S. Treasury sells a bond to a Saudi Arabian prince.
   f. A U.S. tourist flies to France on Air France.
   g. A U.S. company sells insurance to a foreign firm.

18-2 Describe how the foreign exchange rate is determined using demand and supply curves and explain the shapes of the curves

3. *(Determining the Exchange Rate)* Use these data to answer the following questions about the market for British pounds:

Pound Price (in $)	Quantity Demanded (of pounds)	Quantity Supplied (of pounds)
$4.00	50	100
3.00	75	75
2.00	100	50

   a. Draw the demand and supply curves for pounds, and determine the equilibrium exchange rate (dollars per pound).
   b. Suppose that the supply of pounds doubles. Draw the new supply curve.
   c. What is the new equilibrium exchange rate?
   d. Has the dollar appreciated or depreciated?
   e. What happens to U.S. imports of British goods?

18-3 Describe the purchasing power parity theory

4. *(Purchasing Power Parity Theory)* What is the purchasing power parity theory. Is it a short-run or a long-run theory. Why may it not always work?

18-4 Trace the evolution of exchange rate regimes from the gold standard to the current system

5. *(Exchange Rate Regimes)* Briefly trace the exchange rate regimes beginning with the gold standard up to our current system.
6. *(Exchange Rates)* Discuss the differences between a flexible exchange rate and a fixed exchange rate. What measures can the government take to maintain fixed exchange rates?
7. *(The Current System: Managed Float)* What is a managed float? What are the disadvantages of freely floating exchange rates that led countries to the managed float system?

CHAPTER 19

19-1 Besides income, identify ways that low-income economies differ from high-income economies

1. *(Worlds Apart)* Per capita income most recently was about 160 times greater in the United States than in the Democratic Republic of the Congo. Suppose per capita income grows an average of 3 percent per year in the richer country and 6 percent per year in the poorer country. Assuming such growth rates continue indefinitely into the future, how many years would it take before per capita income in the Congo exceeds that of the United States? (To simplify the math, suppose at the outset per capita income is $160,000 in the richer country and $1,000 in the poorer country.)

19-2 Describe the factors that make workers in high-income economies more productive than workers in other economies

2. *(Why Incomes Differ)* What factors help workers in high-income economies become more productive than those in other economies?
3. *(Import Substitution Versus Export Promotion)* Explain why domestic producers who supply a good that competes with imports would prefer an import-substitution approach to trade policy rather than an export-promotion approach. Which policy would domestic consumers prefer and why?

19-3 Explain how trade restrictions can slow economic development in poorer countries

4. *(International Trade and Development)* From the perspective of citizens in a developing country, what are some of the benefits and drawbacks of international trade?

19-4 Outline some unintended consequences of foreign aid on economic development

5. *(Foreign Aid and Economic Development)* Foreign aid, if it is to be successful in enhancing economic development, must lead to a more productive economy. Describe some of the problems in achieving such an objective through foreign aid.
6. *(In-Kind Aid)* What has been an unintended consequences of richer countries giving food and clothing to poorer countries?