

REVIEW QUESTIONS FOR FINAL EXAM

Chapter 13, 10/30-11/15

1. Define long-run aggregate supply (LRAS). What determines the level of LRAS? Why do we say LRAS is potential GDP or full employment output, \bar{Y} ? What do we mean by \bar{U} ?
2. How would an increase in the size of the US work force, an increase in the U.S. capital stock or an advance in technology affect the LRAS curve?
3. Define short-run aggregate supply (SRAS). Why does the SRAS have a positive slope?
4. Which of these factors would result in a shift in the SRAS?
 - a. Increase in the size of the labor force and the size of the capital stock.
 - b. Technological change.
 - c. Expected changes in the future price level.
 - d. Adjustments of workers and firms to errors in past expectations about the price level.
 - e. Supply shock.
5. Draw a graph of the LR macroeconomic equilibrium where $AD = LRAS = SRAS$ at price level equals 100 and output at potential, \bar{Y} . Label the axes. Explain.
6. Starting from LR equilibrium in no. 5 above, show how a leftward shift in SRAS (e.g., oil price shock) can cause a recession.
 - a. Where is SR equilibrium? Describe the economy's automatic adjustment mechanism back to \bar{Y} . At the new LR equilibrium, is the price level higher or lower than $P=100$?
 - b. What is stagflation?
 - c. What happens to wages and prices as the economy returns to \bar{Y} from SR equilibrium? Why?

7. Starting from LR equilibrium in no. 5 above, show how a leftward shift in AD (decrease in Investment spending) can cause a recession.
 - a. Where is SR equilibrium? Describe the economy's automatic adjustment mechanism back to \bar{Y} . At the new LR equilibrium, is the price level higher or lower than $P=100$?
 - b. What happens to wages and prices as the economy returns to \bar{Y} from the SR equilibrium? Why?
8. In your analysis above, what critical assumption must hold in order for the economy to return to LR equilibrium (i.e., automatic adjustment)?
9. What is fiscal policy to stabilize the economy during recession? During inflationary boom? In our AD/SRAS/LRAS model, which curve is affected? How?
10. What is monetary policy to stabilize the economy during recession? During an inflationary boom? In our AD/SRAS/LRAS model, which curve is affected? How?
11. The adoption of the Internet:
 - a. Was the Internet a positive or negative shock to the U.S. economy?
 - b. Was adoption of the Internet a shock to supply or demand?
 - c. How did the Internet affect worker productivity?
 - d. How was the AD/LRAS/SRAS model of the U.S. economy affected? Was AD affected?
 - e. How did the internet affect \bar{U} (unemployment at full employment), ceteris paribus?

Chapter 14 and 15, 11/18 – 12/4

12. What is the problem with using barter for transactions?
13. What is the advantage of using money for transactions instead of barter?
14. What are the functions of money?
15. Are credit cards money?
16. How is money measured? (Define M1 and M2.)
17. When was the Federal Reserve System created? Why?
18. What is the "FOMC"? What is its responsibility?
19. Why is the FOMC so important?

20. At the December 17-18 meeting of the FOMC, what do you think they will be talking about?
21. Short-term interest rate refers to an interest rate on a saving account (e.g., CD), bond or loan of how many years or less? Long-term interest rate refers to an interest rate on a saving account, bond or loan with a term that is greater than how many years?
22. Why did the Fed decide not to taper in its September FOMC meeting?
23. What was the FOMC decision with respect to interest rates (both long-term and short-term) at the October FOMC meeting? Why?
24. Why are market expectations with respect to monetary policy so important?
25. At its December meeting, the FOMC will decide: to keep its foot on the gas pedal or, let up on the gas pedal as the economy (i.e., the car) reaches a healthy speed of growth or, hit the brakes." Under what economic conditions would the Fed decide to keep its foot on the gas pedal? Hit the brakes? Which one of these options is referred to as "tapering" by the financial press.
26. Because short-term interest rates were near zero, the FOMC took nonconventional (or atypical) measures (quantitative easing) to stabilize the economy. What was the objective of these measures with respect to interest rates? (See text page 502.)
27. What is a bond? a share of stock? (See "Stocks and Bonds" in the Monetary Policy folder in ANGEL.)
28. What are the challenges facing the FOMC each time it meets?
29. What are open market operations? What open operations would the FOMC perform during a recession? Inflationary situation? How do open market operations affect the economy?
30. The supply of loanable funds represents lenders / borrowers (**circle one**). The demand for loanable funds represents lenders / borrowers (**circle one**).
31. When the Fed engineers an OMP, how does this affect the loanable funds market? Interest rates? AD?
32. When the Fed engineers an OMS, how does this affect the loanable funds market? Interest rates? AD?
33. Why was the Great Recession "Great"?
34. Is the U.S. economy now back to full employment output? Why or why not?

Chapter 16, 12/6 – 12/11

35. To be continued!