

Review Questions for the Sectional Final

1. Which has a larger impact on aggregate demand, a change in investment or a change in lump sum taxes? Why does the lump-sum tax multiplier have a different effect on output than the government purchase multiplier?
2. Recently, foreign incomes have risen.
 - A) Based on this information, how would you depict the status of the U.S. economy using an AD/AS diagram? (Include LRAS, SRAS, AD and label all axes. Specific numbers are not necessary.) Focus on the short run changes in output, unemployment and prices.
 - B) If the Federal Reserve does nothing – what do Classical Economists predict will happen in the long run to output, unemployment and prices? (Relate your answer, if possible, to the diagram you drew in (A).)
 - C) If the Federal Reserve is concerned with correcting the economy in the short run – describe how the Fed can achieve its objective. What actions could the Fed take in this situation (name three)? Use the money demand, money supply diagram to illustrate the Federal Reserve change and describe the impact this would have on the AD/AS from part A.
3. We focused on two sources of inflation.
 - A) Give an example of why demand-pull inflation occurs.
 - B) Give an example of why cost-push inflation occurs.
 - C) On two separate graphs - graph demand-pull inflation and cost-push inflation. Be sure to correctly label the graph.
 - D) What does this imply about inflation (focus on what happens when there is no government or Fed interaction)?
4. Draw a standard AS/AD graph in equilibrium. Show (on the graph) and explain one thing that could cause the economy to head into a recession. If no changes to fiscal or monetary policy were implemented, what is the long-run process that would bring the economy back into equilibrium? If policy makers did not want to wait for the long-run adjustment, what could they do to return the economy to potential output?
5. Draw a standard AS/AD graph in equilibrium. Show (on the graph) and explain one thing that could cause the economy to head into an expansion. If no changes to fiscal or monetary policy were implemented, what is the long-run process that would bring the economy back into equilibrium? If policy makers did not want to wait for the long-run adjustment, what could they do to return the economy to potential output?
6. What is Monetary Policy? If the economy were in a recession, how could monetary policy be used? That is, what policy would be implemented and how? If the economy were in an expansion, how could monetary policy be used? That is, what policy would be implemented and how?
7. What is Fiscal Policy? If the economy were in a recession, how could fiscal policy be used? That is, what policy would be implemented and how? If the economy were in an expansion, how could fiscal policy be used? That is, what policy would be implemented and how?