This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session for Exam #4 will be held Tuesday 4/18 at 7:30 in the normal room, I hope.

Chapter 13: What is fiscal policy? What should the government do with taxes and spending if there is an inflationary gap or a recessionary gap? Show those actions on the LRAS/SRAS/AD diagram. What are the drawbacks of doing fiscal policy, for example, crowding out investment and lags? Why are these problems? What is the Laffer Curve and why does it matter? What is Ricardian Equivalence and why should it hold? Note that Ricardian Equivalence, the size of crowding out and lags are often debated among economists. What are automatic stabilizers? What determines the size of the government deficit/surplus? Why should we know the unemployment rate when considering the desirability or lack of desirability of the deficit? How does a deficit differ from the debt? Ignore the appendix, except that it can help you understand the chapter.

Chapter 14: What is the difference between the budget deficit and the government debt? What are the problems caused by them? To what extent are these arguments valid: high interest payments hurt, future generations must pay the debt, crowding out, and we owe foreigners the money? How is the government deficit related to the trade deficit? Why is it important to know why the deficit is big? How are the short-run and long-run effects of the deficit different? Why is it difficult to reduce the deficit?

Chapter 15: Why should money be a good medium of exchange, unit of account, store of value, and standard of deferred payment? What is meant by liquidity? What backs our money? Know what is in M1, M2, but not M3. You only have to know the items in them that the book mentions. (There are other parts of M2 and M3 that the book leaves out.) Know the properties of each item in them. Know what happens when we move money between them. Hints: Do not forget that M1 is in M2. Unless you are taking a loan, then M2 doesn't change. What is financial intermediation? What are adverse selection and moral hazard and why are they a problem? Do not worry about what each organization in Table 14-2 does. What is the Federal Reserve? What does it do? What are its tools? How do they affect the money supply? (That is covered in more detail in chapter 17.) The map of the Federal Reserve Districts incorrectly has us in the Richmond District. We are in the Cleveland District.

Non-graded Assignment #8A to be reviewed with #8.

1) (30 points) Suppose a person often does not pay their debts. If they are trying to get a loan, what is the economic term for this? Explain your logic. How can the banks avoid this problem? Explain how that will reduce the problem.

2) (30 points) Suppose that after a person gets a loan, they change their mind and use it to gamble. What is the economic term for this? Explain your logic. How can the banks avoid this problem? Explain how that will reduce the problem.

3) (15 points) What tool does the Fed use the most when they are affecting the money supply? Why do they use it the most?

4) (10 points) In Egypt, the central bank does not do check clearing. What does that do to the liquidity of a checking account? Explain your logic.

5) (15 points) What is the required reserve ratio? Why is it important for the money supply?

Review Sheet for the two parts of the final.

The optional review session for the first part of the final will be Thursday 04/27, at 7:30 in the normal room. (I hope.) The “review session” for the second part will be in class on 4/24.

The two parts of the final will be in the same order as last year, which is the opposite order of the first two semesters. The second half of the final will be just like the second half of the final for the last semester. It will be the same except you will have different numbers and I may change the point breakdown. If I were you, I would use a Keynesian, but not extreme Keynesian, approach to solve the problem because it is easier to solve problems in a Keynesian world. (That does not mean that Keynes is right, just easier to deal with.) Chapter 18, up to page 425 will be helpful even though we will not cover it directly. For the second half of the final, you will probably want to practice showing policy on the SRAS/LRAS/AD diagram, 45° diagram, and the MS/MD diagram **at the same time**. Make sure that GDP goes the same direction in the two diagrams with it on the X-axis.

The first part of the final will be held the last day of class. It will cover the material that is not directly covered by the second half of the final. For example, I will not ask you to show an increase in the money supply on the LRAS/SRAS/AD diagram. Anything on any review sheet that is not explicitly covered in Part 2 of the final is fair game.

When I write the final, I look to see what I did not ask about, and what were the major topics. I write questions about those topics. (Obviously, opportunity costs and supply/demand will be on the first half of the final.) I try to get the questions evenly distributed from all the tests. However, the second half of the final covers much of the material for tests 2, 3 and 4. Therefore, much of the material for the first half of the final will be on material from test 1, with some questions from the other material covered.

Chapter 17: What determines the demand for money? What are transaction, precautionary, and asset demand for money? Be able to move the MS and MD curves. Ignore the S/D for bonds. Illustrate the effects of monetary policy on LRAS/SRAS/AD diagram. Understand why MV=PY. Understand why monetarists do not like monetary policy. (This is the lags from Chapter 13 again, but they are of different lengths than they were there.) Why can’t the Fed choose to set both interest rates and the money supply?

Non-graded assignment based upon chapter 17.

1) (50 points) Illustrate an increase in the money supply on the LRAS/SRAS/AD diagram and on the MD/MS diagram. Explain why the curve(s) moved as drawn.

2) (25 points) Illustrate an increase in the GDP on the supply and demand for money. Explain why the curve(s) moved as drawn.

3) (25 points) Use the supply and demand for money to explain why no central bank can control both interest rates and the money supply. (Of interest, if the central bank wants to control the exchange rate, then it cannot control either the interest rates or the money supply.)