

AP[®] Macro Unit 5: Consequences of Stabilization Policies

Topic 5.1- Fiscal and Monetary Policy in the Short Run

1. Use the chart to summarize how fiscal policy, monetary policy, and no policy can close negative and positive output gaps. Identify if the policy shifts AD or SRAS.

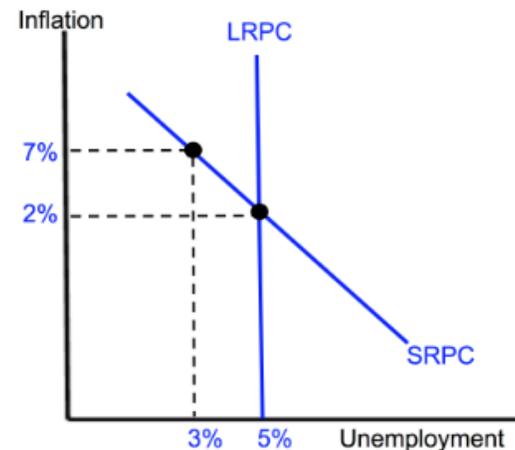
Policy	Negative Output Gap	Positive Output Gap
Fiscal Policy	G↑, T↓ AD↑	G↓, T↑ AD↓
Monetary Policy	RR↓, DR↓, Buy Bonds AD↑	RR↑, DR↑, Sell Bonds AD↓
No Policy	Wages ↓ SRAS↑	Wages ↑ SRAS↓

2. What action could the central bank take to limit inflation caused by expansionary fiscal policy? Explain. The central bank could sell bonds (or ↑RR or ↑DR). This will decrease the money supply, increase interest rates, and limit excessive spending and inflation.

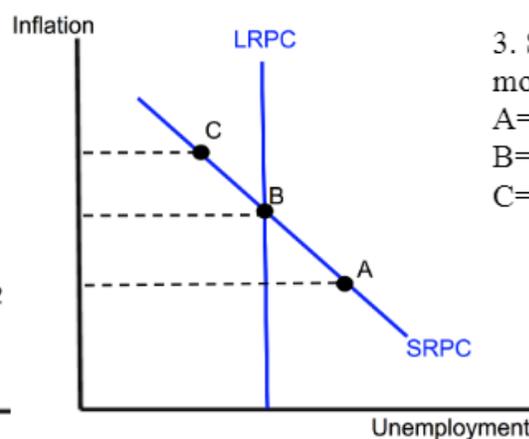
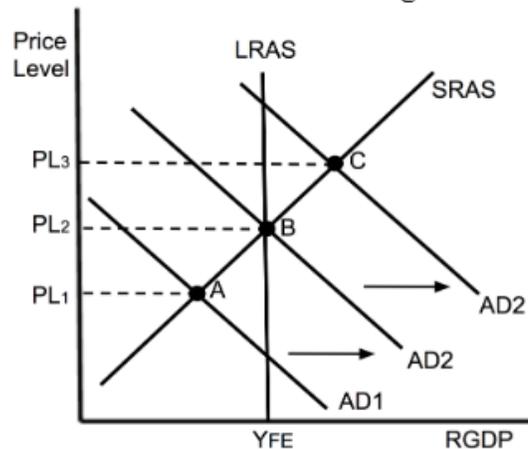
Topic 5.2- The Phillips Curve

1. Draw the short-run and long-run Phillips curve and plot the following values

Expected inflation rate	2%
Actual inflation rate	7%
Unemployment rate	3%
Natural Rate of Unemployment	5%

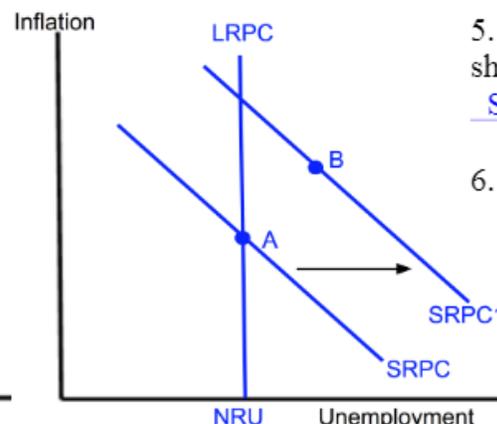
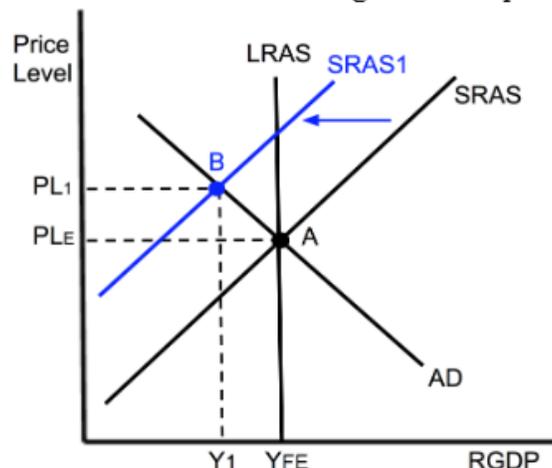


2. Draw the short-run and long-run Phillips curve. Label points A, B, and C based on the changes in AD



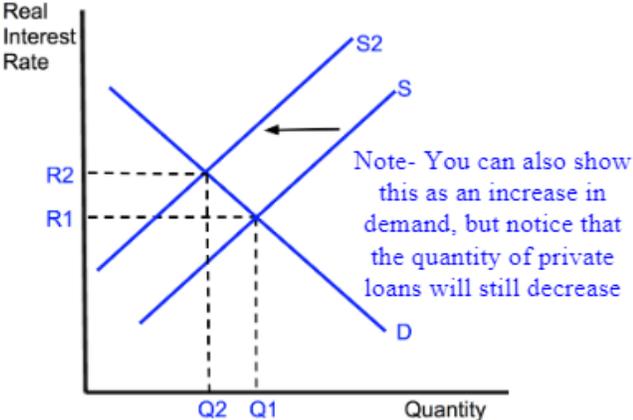
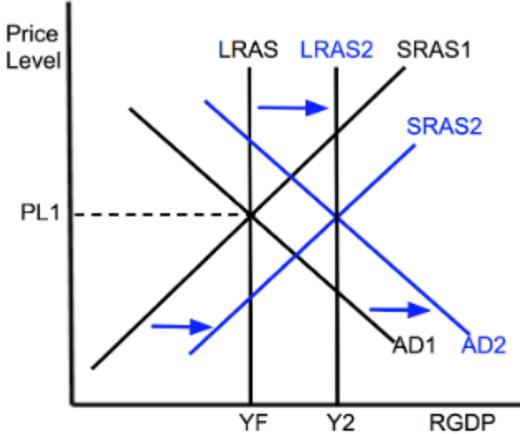
3. Shifts in AD cause movements along the SRPC
 A= Recessionary gap
 B= NRU/Full-employment
 C= Inflationary gap

4. Draw short-run and long-run Phillips curve. Show the result of a negative supply shock on both graphs



5. When the SRAS curve shifts to the left, the SRPC shifts to the right.

6. What shifts the LRPC?
 Anything that changes the natural rate of unemployment

<p>Topic 5.3- Money Growth and Inflation</p> <p>1. What is the equation for the quantity theory of money? $M \times V = P \times Y$ The money supply times the velocity of money equals the price level times the real output</p> <p>2. Define the velocity of money The velocity of money is the average times a dollar is spent and re-spent in a specific period of time</p> <p>3. Assume the money supply is \$40 and it's used to purchase 10 products with a price of \$20 each. Calculate the velocity of money? 5</p> <p>4. When the economy is at full employment, why will an increase in the money supply have no effect on real output in the long run? An increase in the money supply doesn't change the amount of physical capital in the economy or the real output that can be produced.</p>	<p>Topic 5.4- Deficits and the National Debt</p> <p>1. What is a government budget deficit? When tax revenues are less than government purchases plus transfer payments in a given year</p> <p>2. What is a government budget surplus? When tax revenues are more than government purchases plus transfer payments in a given year</p> <p>3. Explain the difference between the budget deficit and the national debt. A budget deficit is the amount the government overspends in one year. The national debt is the accumulation of deficits over multiple years.</p> <p>4. How does the existence of a large national debt effect government spending in the future? Future spending falls. A government must pay interest on its accumulated debt. This means that the government will not have those funds for alternative uses</p>
<p>Topic 5.5- Crowding Out</p> <p>1. Draw the loanable funds market and show what happens when the government deficit spends</p>  <p>2. Use the example above to define crowding out Government deficit spending increases real interest rates and decreases interest-sensitive private sector investment and consumer spending</p> <p>3. Crowding out \downarrow physical capital accumulation and \downarrow the rate of growth</p>	<p>Topic 5.6- Economic Growth</p> <p>1. Identify three things that influence productivity Technology, amount of physical capital, and amount of human capital</p> <p>2. Use the AD-AS model to show what happens in the long-run when lower interest rates lead to more investment</p>  <p><i>True or False</i></p> <p>3. The aggregate production function shows that output per capita is positively related to both physical and human capital per capita True</p> <p>4. An increase in consumer spending leads to more economic growth in the long-run False</p> <p>5. When long-run aggregate supply shifts right the natural rate of unemployment increases False</p> <p>6. A sustained increase in productivity causes both the long run aggregate supply curve and production possibilities curve to shift right True</p>
<p>Topic 5.7- Public Policy and Economic Growth</p> <p>1. Identify three public policies that promote economic growth. Increase in education spending, increase in infrastructure spending, policies that spur innovation</p> <p>2. Define supply-side fiscal policies Laws designed to increase output by shifting SRAS and LRAS by lowering taxes for businesses</p>	