

PROBLEM SET #4 (2 % of grade; 10 points possible)

DUE: At Mon or Tues section, November 26/November 27 Wed/Thurs section, November 28/29

Problem sets lose 5 points if they are 0 minutes - 24 hours late after the start of section. No problem sets accepted more than 24 hours after section begins. Your submitted work must be your own: Problem sets that are identical (in whole or in part) to another student's problem set will receive a zero. Essay must be submitted twice: hard copy attached to this problem set and electronically via bCourses.

IMPORTANT: Place your answers in the area indicated. Problem set answers (other than essay) must be on this sheet to be graded.

1. (2 point) Fiscal Policy

- a. (½ point) Explain why an increase in government spending (G) is supposed to have a larger effect on GDP & employment than an equal-sized decrease in taxes (TA).

- b. (½ point) Our clicker answers on October 24 indicated that, on average, we would change our consumption more in response to a change in income than we would to a change in taxes. Assuming we are an accurate reflection of the economy as a whole, how does that behavior impact your answer to part a?

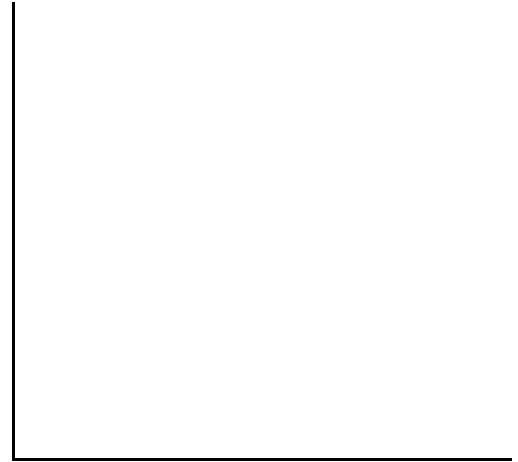
- c. (1 point) Use a PPF to discuss the difference between a [A] fiscal policy action that only increases aggregate demand, and [B] a fiscal policy action that both increases aggregate demand and increases productivity. Which type of fiscal policy action [A] or [B] would make the most sense when the economy is in a recession? Which type of fiscal policy action [A] or [B] would make the most sense when the economy is at full employment? Is the US economy currently in a recession?



2. (2 points) Interest Rates

a. Explain why prices of Treasury bills and interest rates on T-bills are inversely related.

b. What is the federal funds rate (FFR)? Explain carefully how purchases or sales (tell us which one) of Treasuries by the Fed can ultimately lead to an increase in the FFR. Supplement your explanation with a graph.



c. What is "IOER"? What is "FOMO"? What is an advantage to the Fed using the IOER rather than FOMO as its policy tactic?

d. What is a yield curve? Which "end" of the yield curve does the Fed have the most control over? Which "end" of the yield curve has the most influence on aggregate demand? Discuss.

3. Phillips Curve (2 points)

- a. In the graph at the right, draw and label a Phillips curve. In the space below, explain why a change in the unemployment rate leads to a change in the inflation rate.



- b. The members of the Fed's FOMC use the Phillips curve concept in their thinking about monetary policy actions. They recognize that the Phillips curve can shift. Read the 3 articles below (links are live in the version of the PS on the course website). Then discuss these questions: Why do recent data (2010 to 2018) make it seem the Phillips curve is now flat? What factors could have shifted the Phillips curve over the last 8 years? Why should we expect the flatness of the Phillips curve is temporary and not permanent?
- <http://economics21.org/commentary/fed-phillips-curve-caroline-baum-11-04-2015>
<http://www.nytimes.com/2015/10/25/upshot/the-57-year-old-chart-that-is-dividing-the-fed.html>
<https://www.stlouisfed.org/on-the-economy/2015/september/phillips-curve-unemployment-down-inflation-low>

4. (1 point) Crowding Out

- a. When the government budget deficit increases, all else constant, what is the effect on interest rates? Explain your logic. Draw a graph that illustrates your answer.
- b. The effect you described in part a leads to “crowding out” – when increased government deficits cause higher interest rates which in turn cause decreases in investment and net exports. Identify and explain a circumstance under which an increase in government borrowing would not lead to higher interest rates.

5. Essay. (3 points total)

In many states in the U.S., high school students are required to take an economics course in order to graduate high school. Many of those courses suffer from an effort to cover way too much material. Students leave the course having seen so much that they are unable to remember anything. Moreover, in many economics principles courses, the concepts are rarely tied to any real world applications and so students leave the course unable to take anything they’ve learned and apply it outside of the classroom. Therefore there is a movement in the US to focus on economic literacy: teach a handful of concepts in a way that makes them “stick” so that students can remember and, more importantly, apply the concepts in the months and years after the course ends.

Make a list of the top three economic concepts that you think should be taught in a HS economics class and defend why you chose those three concepts. Remember the goal: students should be able to remember the concepts after the course ends, and should be able to apply the concepts in real world contexts. Which three concepts would you choose, and why?

Your essay must be your own work. To present anyone else’s work as your own is theft of intellectual property: plagiarism. That means you must use quote marks “ ” around any words you quote exactly from any source (and then provide the source for the quote). It also means that if you get ideas from anyone else, or if you paraphrase someone else, you must again give them credit for their ideas. To do otherwise is plagiarism: the theft of intellectual property, a violation of the Code of Student Conduct and one of the worst offenses in academe. If you have questions about whether or not you’ve properly cited your sources, please talk with your GSI, the Head GSI, or Prof. Olney. “Your own work” also means that essays crafted jointly on piazza or otherwise are not acceptable. That too is plagiarism. As is reusing an essay you wrote for another class; your work for each class must be original.

Specifications: Essays should still fit on 1 page, but you can use anything between 1.3 and 2.0 line spacing. (“Works Cited” list, if you have one, can be on a second page.) 1.3 to 2.0 line spacing. 9-10-11-12 pt font. 1" margins on all sides. Your name, date, and the word count in the top right corner. Attach your paper directly behind the problem set sheets.

Submission: Essay must be submitted twice. [1] Attach a hard copy of your essay to your problem set sheets. [2] Submit the essay electronically via bCourses, assignments tab. Electronic submission must be completed by 6 pm on the day your problem set is due (~~Wednesday 10/11 or Thursday 10/12~~ **Monday 11/26 or Tuesday 11/27**). Acceptable formats: doc, docx, pdf. bCourses will check your paper using TurnItIn to ensure you have not plagiarized from published sources or previously submitted papers.

Grading: 0 - 1 - 2 - 3 points, taking into account content, following specifications, and writing quality. No submission on bCourses results in a 0 on the essay.