46.1.1

# Monetory Policy 1
Notes

11/19

32 Goals
make decisions for the best of econ
* assist econ in achiving full employment w/o inflation
does it by ajusting reserve requirements

Balance Sheet
Assets
Securities
gov bonds Fed purchased
Treasury bills (short-term) + bonds (long term)
35 most bought in open market exchange
influence banks reserves
-? how again?
Loans to Commercial Banks
like how banks loan to people
Liabilities
37 Reserves of Commercial Banks
Treasury Deposits
treasury parks $ here
Fed Notes ($) outstanding
our $ is a promise to pay
Tools of Monetary Policy
Open Market Operations
buying + selling gov. securities
Buying securities
reserves increased (banks get $)

46,1,2

from banks
- bank: ↓ security + ↑ reserve ↓ liability
42 - Fed: ↑ securities + ↑ bank's reserves
- bank's lending ability ↑

from the public
- much the same
- but when deposited in bank, bank
44 ↑ reserves + ↑ deposits ← ↑ loan ability

however when buying from banks can ↑ excess reserves more then just buying from public, b/c w/ public also ↑ Deposits

Gov Selling Securities

To banks
Bank: ↓ reserves + ↑ securities
Fed: ↑ reserves ↓ securities + ↓ liability demand

To the public
same, but again only reduced by smaller amt b/c also ↓ deposits

But always it ↓ loans (↓ money supply)
(↓$ supply is affected by multiplyer)

when ↑ interest People + Banks buy bonds ↑ Demand ↑ Price ↓ Yield
52 - prompt people to sell them to gov again

Gov Selling Bonds ↑ yield → ↑ demand → ↑ loans

# Decent evidence that Fed's tightening is working

**CASSEL** from D1

page-turning is simply that time is of the essence when it comes to the Federal Reserve and inflation.

It takes time — theorists say anywhere from six to 18 months — for an interest-rate hike by the Fed to work its way through the economy and affect the pace at which prices change.

First the central bank adjusts its short-term lending rate, the amount banks charge one another for overnight loans.

Banks typically pass that rate increase on to their customers right away, raising the benchmark, or "prime," rate. That governs how much firms pay for lines of credit or short-term business loans.

Faced with higher borrowing costs, businesses eventually adjust their own plans, perhaps scaling back an expansion or delaying a building project. How much, or how fast, depends on a myriad of circumstances, and varies from case to case.

(That complexity is precisely the strength of this system: The government doesn't tell businesses how quickly or slowly they can grow. It merely adjusts the price of credit, and lets everyone figure out what to do about that.)

Much of what we know about this, by the way, comes from economist Milton Friedman, who died yesterday. It was Friedman who insisted, simply and clearly, that inflation was entirely a function of how much money the government (that is, the Fed) allows to circulate through the economy.

If the money supply grows faster than the overall production of goods and services, inflation results. If not, Friedman said, prices will be generally stable. Simple.

So why isn't controlling inflation a simple matter for the Fed? A lot of it has to do with the time lag.

We talk about the government "printing" money, but most money isn't printed at all; it's created in the form of bank deposits, consumer credit or business lending.

It's not as if the Fed can simply count how many $10s and $20s are being shipped out of Washington each day. How much money is created on any given day is impossible to know.

Instead, the Fed measures money growth indirectly, and over time. That means today's statistics can reflect decisions the central bank made three months, six months, or more than a year ago.

Which brings us back to last month's inflation figures.

The Fed began raising rates 29 months ago, taking 17 quarter-point baby steps over the course of two years to bring the rate from a rock-bottom 1 percent to the current level of 5.25 percent.

Rates were so low to start with that those first hikes probably weren't even felt. But gradually, as the Fed's rate crept past 3 percent or 4 percent, the changes began to take hold.

At least that's the way it looks.

The Consumer Price Index actually fell in October, dropping a half percent, thanks mainly to tumbling gasoline prices. But even the "core" rate, which excludes food and energy, was subdued, rising a modest 0.1 percent.

That's comforting to the Fed, and also to investors, who would love nothing better than for the Fed to start cutting its rate again early next year.

But will that happen? That's unclear. Some economists think the lower inflation numbers might be just a fluke, and worry that labor costs, among other things, could start pushing them up again soon.

We'll know more in time.

E-mail acassel@phillynews.com or phone 215-854-5981.
Read his recent work at http://go.philly.com/andrewcassel.

46.2.1

# Guess what? Inflation fight may be working

**Andrew Cassel**
*The Economy*

Sometimes things actually work like they're supposed to.

That seems to be the case with inflation. Yesterday's report on consumer prices in October offered a sign — not proof, mind you, but decent-quality evidence — that inflation has begun to ease.

This is after several years in which the monster was rattling its cage, and worrying the folks charged with keeping it safely locked up and quiescent. That would be the Federal Reserve.

More to the point, yesterday's news comes four months after the Fed last tightened the bolts of that cage, also known as short-term interest rates. The central bank had been gradually turning the screws for a full two years, beginning in June 2004.

The reason for all this calendar-

See **CASSEL** on D7

47,1,1

# Monetory Policy 2
## Notes

11/20

Reserve Ratio

53 Fed can also vary min. reserve ratio

↑ ratio ↓ excess reserves ↓ loans or ↓ deposits ↓ supply $

affects single bank + entire system

↓ ratio ↑ excess reserves ↑ loans ↑ $ supply

Δ $ supply in system affected by multiplyer

Δ ratio = Δ multiplyer amt

Discant Rate

57 banks sometimes need emergancy $

— Fed loans them $ at discount rate

give gov securities as collatteral

all the $ goes to excess reserve (not min amt)

59 ↓ discount rate = ↑ loans

changed by Fed goverers

Easy $ + Tight $

to get econ out of recession

1, Fed buys securities

2, ↓ reserve ratio

3, ↓ discount rate

easy $ policy

— to slow inflation

1, Fed sells securities

2, ↑ reserve ratio

3 ↑ discount rate

tight $ policy

61 Relative Importance

of the 3 open market operations are most important

47, 1, 2

—discount rate less important b/c only 2-3% of
bank reserves from this way + banks need to take the rate
though some economists say it has announcement effect
-others say just passive + not used for policy changes

05 -reserve requirements not changed often
-changes bank's profits
— securities used b/c changes are fast + moderately
directly

07 Monetary Policy, Real GDP + The Price Level
Cause Effect Change
Money Market

09 demand for $ inversly related to interest rate

50 =librium interest set by supply of $
Investment
investment is feasible if expect return > rate
prices of expensive things vary
↓rate = ↓ cost of money + ↓ cost of securities
-businesses will pay w/savings for capital
↑rate = businesses buy more securities

55 =librium GDP
↓rates = ↑ investment = ↑ AD = ↑ GDP

Easy $ Policy
Problem: unemployment + recession → does 1 of 3 things (see back)
↑excess reserves = ↑$ supply = ↓rate = ↑investment = ↑AD
= Real GDP rises by multiple of investment

Tight $ Policy
Problem: inflation, 1 of 3 things: ↓excess reserves =

00 ↓$ supply = ↓ investment = ↓ AD = ↓ inflation

4.8.1.1

# Effectiveness

11/21

01 Policy Effectiveness

steeper the $D curve is the more change is felt
thus have greater effect on AD + GDP +
flatten investment curve ← ?why

Feed back Effects

Easy $ policy off sets intrest rate-reducing
07 effect b/c of ↑GDP will raise rate ???

Monetary Policy + AS

Shape of AS effects policy's effectivness
steep or vertical would tranlate easy $
effects just to inflation (=bad)

Effectiveness of Monetary Policy

Strenths

many economists thinks it benifits USA
Speed + Flexability
unlike monatary policy, it can be quickly changed
10 Isolation from Political Pressure
governers not directly affected by politics
has more subtile + less visable effect
- don't change taxes or gov services
Sucess During 90s
12 was very good at ↓inflation in 80's + 90's
ended 90-91 recession
fiscal policy not used as much b/c
14 Congress wants to balance budget

48.1.2

14 Short comings + Problems
Less Control
$ can now be quickly converted to near $
global markets hurt control
new e-$ is harder to regulate
however these aren't having big effect
Cyclical Asymmetry
easy $ policy may not force people to invest
or banks may not make loans
17 tight $ policy forces banks to slow down
However this has not created big problems.
Changes in Velocity
# of times per year $ spent
↓intrest rates = ↑ asset demand = ↑ more $ on hand
= each $ will be spent less times
- will offset easy $ policy
21/29 Investment Impact
some think Δ $ supply ≠ Δ investment
investment curve also affected by tech+ expectations
Intrest as Income
businesses + household make $ from interest
makes spending vary directly w/ rate
33 partly offsets policy effects

48.1.3

Fed Funds Rate

recently Fed announces plans in advance by predicting

prime intrest rate · tracks this rate

- (rate banks charge best clients)

both are not set by Fed, but Fed can do things

36 to change them

TV 06 Monetary Policy + International Economy

Net Export Effect

Fed Policy = ↑ $ Supply = ↑ rate = ↑ demand for $

expansionary fiscal

this raises prices for US exports + makes imports cheaper

15 - reduces effect of expansory policy

easy $ policy has oppset effect + furthers direction

TV 26 - ↑ $s = ↓ rates = ↓ internat = ↓ $ value

net export effect continues policy unlike fiscal policy where opposite

33 - foregine goods become more expensive

- exports cheaper

furthers econ expansion

so unlike fiscal policy, monetary policy helps expan

35 Macro Stability + Trade Balance

if US should have trade balance (net exports = 0)

both goals → that is helped by expansionary policy

38 - ex: tight $ policy ↓ exports + ↑ imports

Last Word: For Fed → Life is a metaphor

Mechanic: tighting + loosining things

Warrior: must fight inflation

Fall Guy: politicans presure Fed to create jobs

48 Cosmic Force: has power + mystery - affects a lot

48.2.1

# Feds 3 Tools
## Inclass Notes

11/22

1. Reserve ratio
   - min amt banks need to keep
   ↑ rate = less loans = ↓ $ supply

2. Discount Rate.
   - $ Fed charges for banks to loan $ from it
   ↑ rate = ↓ loans = ↓ $ supply
   affects the prime rate
   · shadow rate = Fed. funds rate
     - banks would rather lend from other banks
     - predicts where econ heading

3. Open Market Operations
   - buy + sell securities
   - run by Open Market Committee
   - at New York Fed Bank
   · to ↑ $ supply - Fed buys bond - that puts $ in the world - the $ ↓ intrest rate ↑ investment which ↑ AD and ↑ GDP

 48, 3, 1.. ✓ Michael Plasmeier

## ACTIVITY 39 continued

2. What is monetary policy?
Controlling the $ supply to stabalize econ.

3. What happens to interest rates if the Fed follows a contractionary, or tight, monetary policy?

4. What happens to interest rates if the Fed follows an expansionary, or easy, monetary policy?

5. What is the federal funds rate?

6. Why do observers pay close attention to the federal funds rate?

7. Circle the correct symbol (↑ for increase, ↓ for decrease). What would happen to the money supply and to interest rates if the Fed:
   a. Sold government securities on the open market.
      Money supply ↑ ↓
      Interest rates ↑ ↓
      $ comming in of Fed
   b. Bought government securities on the open market.
      Money supply ↑ ↓
      Interest rates ↑ ↓
      $ going out of Fed
   c. Raised the reserve requirement.
      Money supply ↑ ↓
      Interest rates ↑ ↓
      less loans
   d. Lowered the reserve requirement.
      Money supply ↑ ↓
      Interest rates ↑ ↓
   e. Raised the discount rate.
      Money supply ↑ ↓
      Interest rates ↑ ↓
      duh!
   f. Lowered the discount rate.
      Money supply ↑ ↓
      Interest rates ↑ ↓

## ACTIVITY 39 continued

8. In the table *Tools of Monetary Policy* indicate how the Federal Reserve would use each of the three monetary policy tools to pursue an expansionary policy and a contractionary policy.

**Tools of Monetary Policy**

| Monetary tool | Expansionary policy | Contractionary policy |
|---|---|---|
| Open market operations | buy bonds (send out $) | sell bonds |
| Discount rate | ↓ | ↑ |
| Reserve requirements | ↓ | ↑ |

9. a. What kind of monetary policy would the Fed probably follow if the country had an annual inflation rate of 15 percent?

   b. Why? Contractionary (tight $)
   15% inflation is bad for econ would want to ↓ that by slowing econ

10. a. What kind of monetary policy would the Fed probably follow if the country were in a severe recession with high unemployment and falling prices?

    b. Why? expansionary (easy $)
    would want to jump start investing by having more $

49, 1, 1

# Graph It

11/25

49 Determaints of Level of output, employment, income + prices
- Supply
  - Input Prices
    - Domestic Resource Avalibility
      - Land
      - Labor
      - Capital
      - Entrepreneuraial Ability
    - Price of Imported Resources
      - Exchange Rate
    - Market Power
      - Anti trust
      - labour Laws } Gov regulates (Public Policy)
  - Productivity
    - Edu + training
    - Tech
    - Quantity of Capital
    - Management
  - Legal - Institutional Enviroment
53 - Business Taxes + subsidies } Public Policy
    - Gov Regulations
- Demand
  - Consumption (C)
    - Level of GDP
    - Consumption Schedule
      - Wealth
      - Price Level } $\frac{1}{1-MPC}$
      - Expectations
      - Indebtedness
      - Tax levels ← Public Policy

55

49.1.2

55 Investment (Ig)
- Expected Rate of Return
  - Tech Changes
  - Capital Costs
  - Stock of Capital Goods
  - Expectations (Confidence)
  - Tax Levels ← P.P.
- Interest Rate
  - Demand for $
    - Transactional
57 - Asset
  - Supply of $
    - Easy $ policy
      - Buy securities
      - ↓ Reserve ratio
      - ↓ Discount rate
    - tight $ Policy
      - Sell securities
      - ↑ Reserve ratio
      - ↑ Discount rate

Public Policy

Net Exports (Xnet)
- Imports
  - Domestic GDP levels
  - Exchange Rate
- Exports
  - GDP levels abroad
  - Exchange Rate
- (Price Level
- Interest Rate
  - Fiscal Policy
60 - Monetary Policy

Public Policy

49.1.3

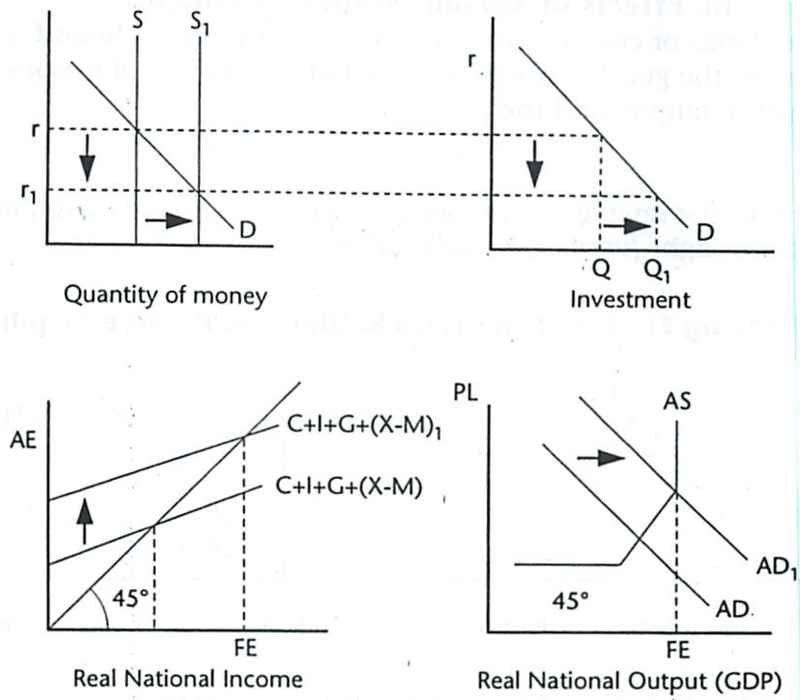
Gov Spending (G)
  Federal
    Fiscal Policy
      Deficit or Surplus
        Discretionary action
        Automatic Stabilizers
        Size
        Method of finance or disposition
    Nonstabalizing and non economic consideration
02 State + Local

49.3.1

ACTIVITY 41 continued

Michael Plasmeier

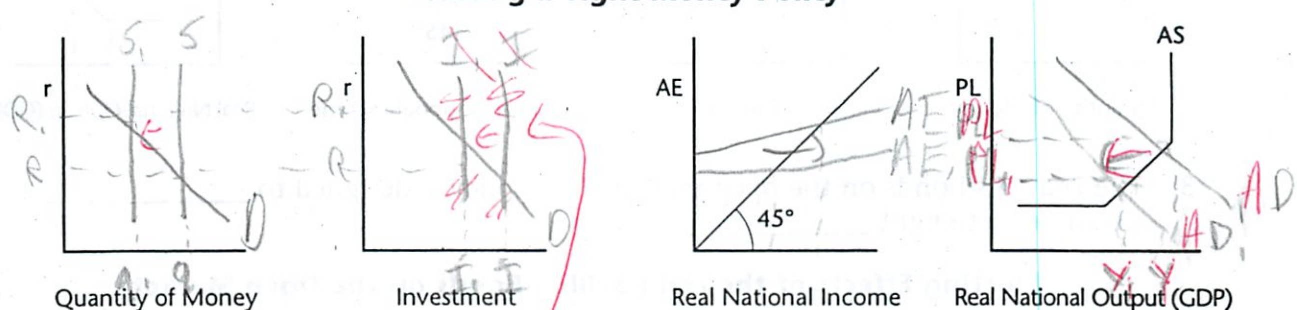
### Easy Money Policy




### Contractionary Monetary Policy

A contractionary monetary policy or tight money policy is used to fight inflation. The Fed decreases the money supply to increase interest rates. The increase in interest rates decreases investment. The decrease in investment decreases AE or AD. Draw four graphs to illustrate a tight money policy.

### Plotting a Tight Money Policy




don't have vertical lines

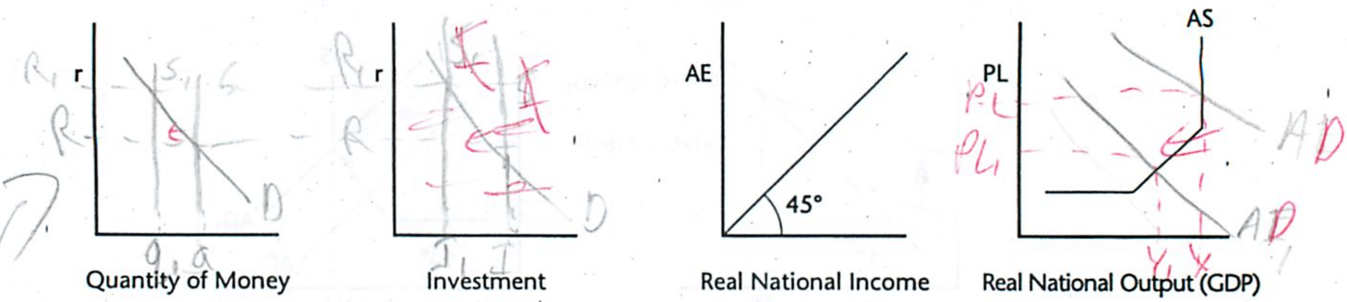
# ACTIVITY 41 continued

**Part C. Graphing the Effects of Various Monetary Policies**

Fill in the answer blanks or cross out the incorrect words in parentheses for the sentences that follow. Then use the graphs provided to illustrate the effects of various monetary policies on aggregate demand, output, and the price level.

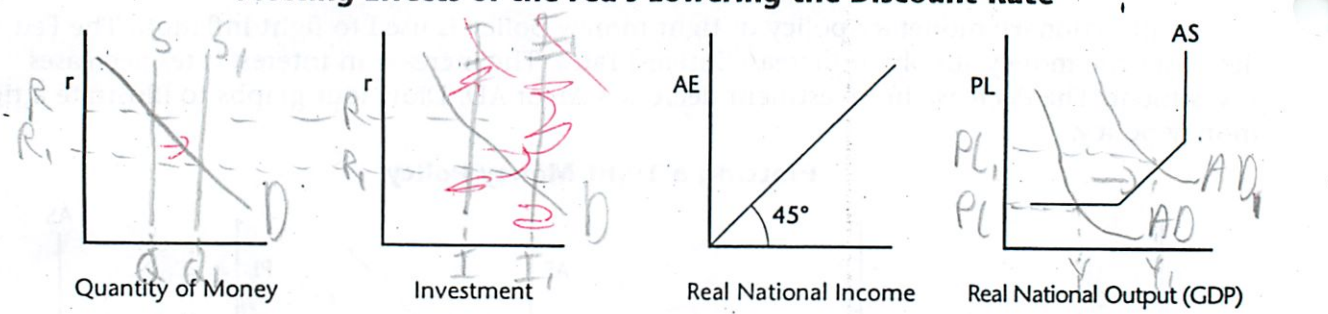
1. The Fed raises the reserve requirement. This policy is designed to *(increase/decrease)* AD in order to fight *(unemployment/inflation)*.

**Plotting Effects of the Fed's Raising the Reserve Requirement**



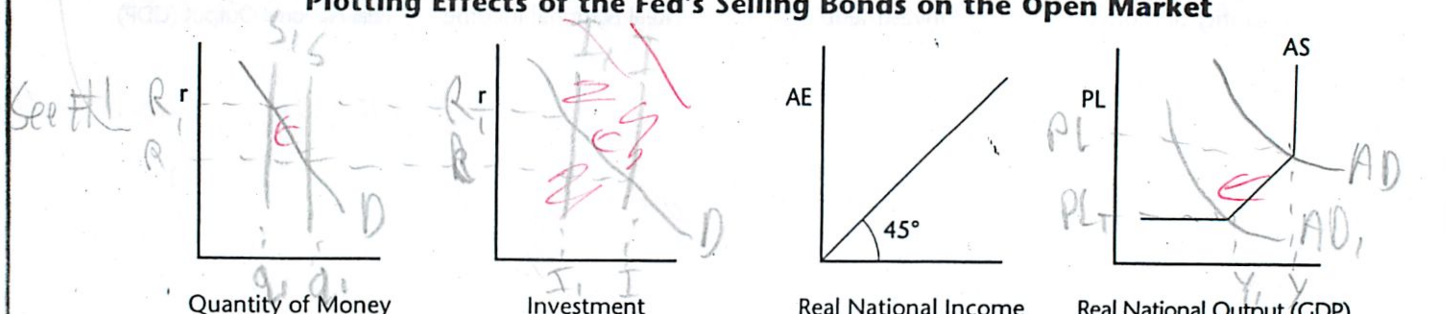

2. The Fed lowers the discount rate. This policy is designed to increase AD in order to fight unemployment.

**Plotting Effects of the Fed's Lowering the Discount Rate**




3. The Fed sells bonds on the open market. This policy is designed to decrease AD in order to fight inflation.

**Plotting Effects of the Fed's Selling Bonds on the Open Market**

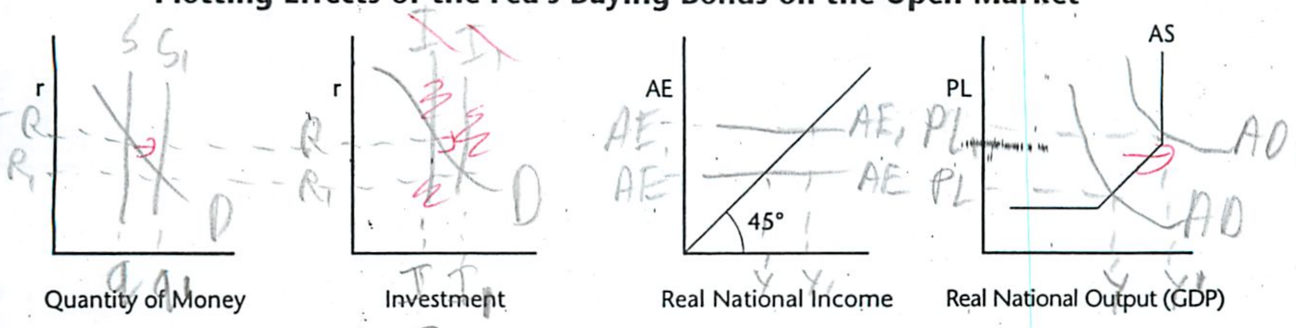


## ACTIVITY 41 continued

4. The Fed buys bonds on the open market. This policy is designed to expand ↑ AD in order to fight unemployment.

**Plotting Effects of the Fed's Buying Bonds on the Open Market**

See #2




↑ Capital letters

↑ don't forget arrow

49.4.1

Sample Test 3

A.P. Economics

Pre-Test:- Part 3 (AP 124- ~~305~~ 324)

Dr. Reilly

Directions: You have 50 minutes to answer all of the following questions. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list results of your analysis. Include diagrams, if useful or required, in explaining your answers. All diagrams should be clearly labeled.

1. (50 points)

Assume that you are a member of the Federal Reserve's Board of Governors. You receive the following data on the economy:

only a month

ok ↓ .5%·12=6%

| | Year ago | Month ago | Now |
|---|---|---|---|
| Real GDP (billions of dollars) | 3,600 | ↓ 3,540 | — 3,540 |
| Consumer Price Index | 210 | ↓ 215 | ↑ 216 |
| Unemployment rate | 7% | ↑ 10% | ↑ 11% |
| Gross private investment (billions of dollars) | 602 | ↓ 570 | — 570 |

← still inflation (slow)

← unemployment (fast)

a. What problem is the nation facing? Unemployment (not slowing b/c need to ↑2)

b. Do you want to increase or decrease the money supply? Justify your position. increase

c. Describe the monetary policy you recommend. What are your options? What exactly would you do? Be sure to discuss two tools the Fed could use to achieve the goals of your policy. ← 1. ↓ discount ↓ reserve

Fed → buy securities

do OPMO

↓ reserve ration - create more $

d. Describe the effects of your monetary policy on:
   i) Interest rates.
   ii) Investment. your specific one
   iii) Output.
   iv) The price level. ← depends where you are, but look where you are
   v) Employment.

e. Illustrate the effects of your monetary policy using:
   i) An aggregate demand/aggregate supply graph.
   ii) A Keynesian aggregate expenditure graph. do both

(last 2 of 4)

or could do all 4

(50, 1, 1)

# AD-AS Analysis Notes

11/29

22 school

Some think AD-AS is missing some parts
- is it self correcting?
- does fiscal + monetary policy work

## Short-Run + Long-Run AS

so far have assumed AS doesn't shift with AD
however ↑PL will make workers want ↑wages which ↓AS

26 Short Run Definition
- period where nominal wages (+ other input prices) remain fixed as PL changes
- Workers take time to become awear PL changed
- Union contracts only let wages change certain times

Long-Run
- period where wages are fully responsive to ΔPL
- 29 real wages remain the same (all else =)

## Short Run AS

Long Run AS always vertical - always comes back in the long-run

what we learned before
ΔPL = Δ real wages
ΔPL : Δ production might need to hire or fire people
- in the short term AD + AS might not meet on it, but input prices will Δ to it in Long run

Long Run AS
31
- nominal wages are fully responsive to PLΔ
- 02 increase in PL initally increases quant. supplied but then S shifts as wages go up lowering
- 06 the long run level of production + people quit 2nd job
- curve is closer to vertical

extended Model

## Equalibrium

long AS + reg AS + AD all intersect same point

08 ~~always~~? no see above

want AS Long to shift to right for more output at same PL

50.1.2

08 Applying extended model
Causes contraversies (next chap)
Demand - Pull Inflation
$\uparrow AD = \uparrow PL$
the inital $\uparrow AD$ causes temp $\uparrow AS$ then wages go $\uparrow$,
shifting AS $\uparrow$
10 in the end Q — + PL $\uparrow$
so dosn't cause any real Q $\Delta$
inflation makes econ go back to $Q_F$

Cost - Push Inflation
as before $\downarrow$ AS causes PL $\uparrow$ + Q $\downarrow$
14 $\uparrow$ initiating cause
AD doesn't auto shift
gov might $\uparrow$ emp. but this also $\uparrow$ inflation
15 Wage-price spiral
Cycle goes on for a while (spiral)
w/o policy $\Delta$ - will be recession but then PL $\downarrow$
and firms can start up again $\downarrow$ Q + Emp.

19 Recession
these ideas are contraversal
if AD suddenly $\downarrow$, PL + Q $\downarrow$ cutting
wages (if $\downarrow$ flexable)
21 ?? The lower PL $\uparrow$ real wages and lowers nomial
wages back to previous levels
Econ back at starting point auto. but
w/a $\downarrow$ PL
some economist think these actions take
23 lots of time

50, 2, 1 Michael Plasmeier

# Chap 16 ✓

Study Questions

11/29

25 1. Short run is the period of time when wages have not yet adjusted to the Δ PL, Long run takes this into account, Long run has the ↓S when wages rise. It is important to know this because Q can't always ↑

2. a False - the higher the PL - the more producers want to make
b False - that's short-term - long term counts that
c True - ↑PL means nominal wages must ↑ to keep same real wages

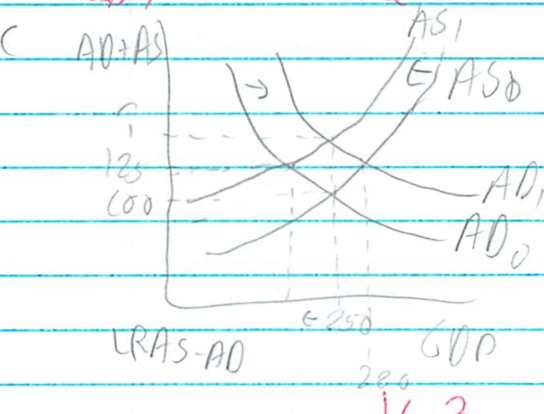
~~↑220~~ decrease too yes

28 3. 250 → 280 ↑P makes producer want to make more
16 250 → 220 ↓PL makes " " " " less

?

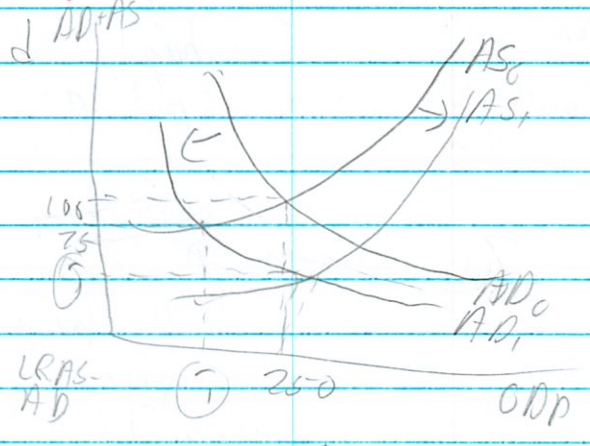
? b. The output will remain the same, but the PL ↑
250, 250 wt + Q remains same 1 yes

c



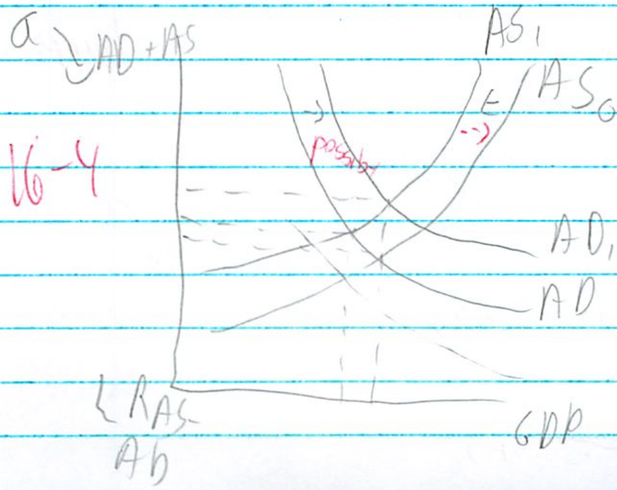

16-3

d




23 4. b ↗ c ↗ 16-5

a



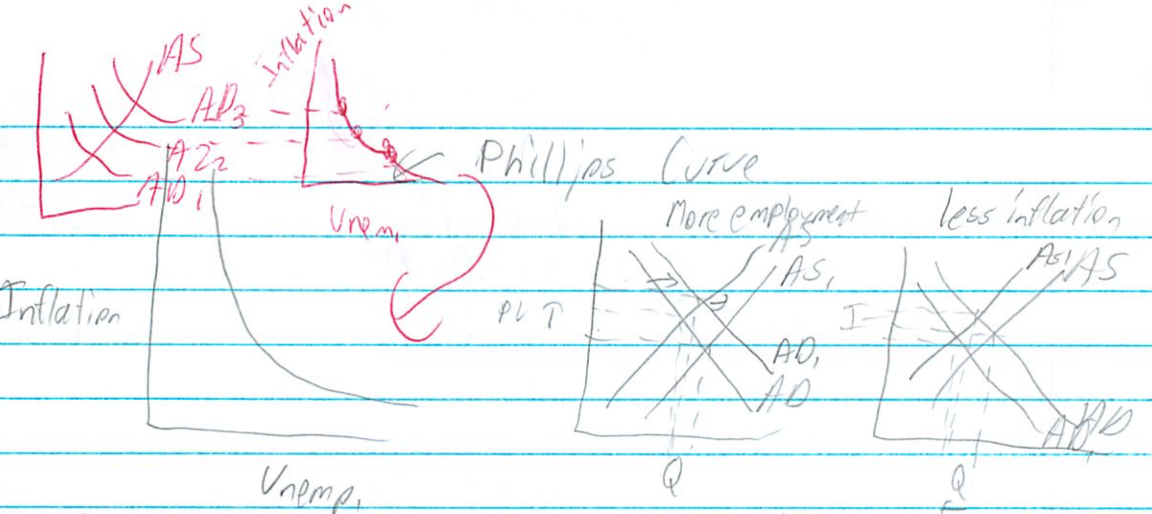

16-4

← AD increases as gov makes bad policy

26

50, 2, 2

2 to 2 5.




(??)

14 6. If people think that PL↑ they will want a wage↑ now, in rational theory. (?) However most people are slow to change their expectations about the future. ↑ adaptive

12 With an rational rate, the phillips curve will be vertical because the short range change is negated.

1 Flipped to 2 yup

Unemployment will not be affected by S or D change because the Δ in supply costs relating to wages is already accounted for. On the other hand, an addaptive rate lets the change in output affect employment which then, after some time affects wages.

adaptive: previous is slow

rational: think ahead

10

~~complicated~~ Correct

7. ~~Correct.~~ As above, if people know what the rate is, they will change their wages ahead of time. However, when the gov does that action, inflation happens. If they just left it alone, a mini recession would happen. I think this might affect the unemployment rate if it doesn't happen

22

8. 1. High taxes discourage people from working, the laffer curve shows this. If taxes are too high, it says output (and actual revenues) will start to shrink. Also supply siders say that regulation increase cost.

25 ~~One more?~~ no

50, 2, 3

-

9. If supply siders are right, the person will pay more tax because they are

?

?? don't know

$\downarrow$ rate = $\uparrow$ work = $\uparrow$ rate

$\uparrow$ so

cost of leisure $\uparrow$

— but people might just work less b/c can reach goals easier

30

10. Correct. Price + Wage controls are just going after the symptoms, not the problems. The underlying causes are $\uparrow$ \$ supply, $\uparrow$ investment \$ + $\uparrow$ supply shocks. Wages + prices only reflect that like theromometers only report the heat.

50,3,1 Michael Plasmeier

Long Run AS

LW Activity 18

11/30

1. Trade-offs between different goods; full production capacity; goods become more expensive as you make more

2. Trade-offs are nessassry to produce one good over anoter.

3. The total production capacity → input prices, wages, productivity + legal-instutional environment

4. When input prices are totally flexable, how much output can be produced at the "normal" or same real price level
?? use this

5. Unless there is technological advance, ↑ productivity ?? the amount of goods which can be produced at stable, equallibrum levels in the long run will always be equal

6. No, and no, LRAS only can change with changes in technology (? and productivity ?)

7. The economy is under producing because of a drop in exports (or something else). If its at point C on the PPC, wages (should) be cut, reducing AD to match the lower AS. AS will then increase as more people return to work (??) and production would go back to normal at a lower PL.

8. The economy is already at long-run AS. Everything (should) stay the same, at PPC point B.

9. The economy is over producing at PPC point A. This will cause inflation causing AS ↑ ↑ PL. People then will want wage ↑ which ↑ imput prices ↓ AS back to the LRAS but at a ↑ PL

10. See #9

11. Tech advances → productivity → gov interaction

12. The curve will move to the right.

51,1,1

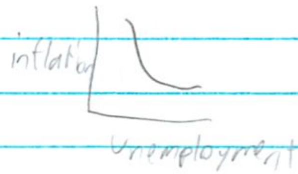
# The Phillips Curve

Notes 11/30

09 A.W. Phillips - Great Britian

## Basic Idea

assuming constant SR AS, high rates of inflation comes with low unemployment




11 ## Tradeoffs

economists believe that predictable tradeoffs would happen

1960's USA
- bulk of economic policy built on it
- ↑ policy ↑ AD ↓ unemployment but ↑ inflation
- must choise one or other

## Stagflation: Shifting Phillips Curve

relationship became unstable

stagflation - ↑ inflation and ↑ unemployment

no dependable tradeoff

16 or just curve shifts rightward (=bad)

## Adverse AS Shocks

cause of 70s+80s recession might be AS shocks

sudden ↑ resourse prices

most significant was OPEC ↑ prices by 4x

12 this ↑ price of almost all other goods

AS left shift ↑ PL → ↑ unemployment

## Stagflation's Demise

in 81-82 big tight $ recesson shifted curve to the left

21 also foreign competition ↓ prices

51,1,2
Misery Index - unemployment + inflation
↓ to better

22 Natural Rate Hypothesis
1. Shifting of curve caused by AS changes during abnormal periods
25 2. view is that econ is stable at natural levels
of employment - and Phillips Curve is wrong
this caused gov to push unemployment too low (beyond natural)
this accelerated inflation
any inflation that is w/ natural unemployment is good

28 Adaptave Expectations theory
people form expectations about future intrest rates,
based on old inflation rates
expectations slow to change
* only short run trade off (no long)
attempts to reduce unemployment below natural
rate destabilies Phillips Curve + moves it →

Short-Run Phillips Curve
- if AD artificially ↑ (b/c gov misjudged unemployment
#s and wrongly has easy $ policy) that
will ↑ inflation b/c AS ↑ as production
and employment ↑ this makes inflation
34 - cost of additonal unemployment is inflation
* - natural rate theory is that when actual
inflation is higher then expected, profits
temp ↑ and unemployment temp ↓

Long-Run Phillips Curve
workers will want wage ↑
profits fall to previous levels
now there is higher actuall + expected inflation
38 process might be repeated if gov makes mistakes
* gov's attempt to move along short term curve
can cause the curve to shift in long run

51,1,3

46 - Disinflation
- also works to ↓ inflation
↓ AD reduces inflation, profits fall, firms ↓ employ
and we move along Phillips Curve
- natural rate: when actual inflation < expected
42 profits temp ↓ + unemployment temp ↑
- wages eventually fall, profits restored,
employment rises again to same unemployment
level but at ↓ PL
- if AD continues to ↓ - will go on
43

Rational Expectations Theory
2nd version of Addoptive Expectations theory
bussinesses + consumers anticipate Δ gov policy
workers may anticipate inflation + demand raise now
if correct → even temp increases won't occur
- Phillips Curve will be vertical
- the expansionary gov policy then make too
much employment + inflation happens
* some say: "gov's good deeds usually fail"

48 Changing Interpretations
thoughts on Phillips Curve changed alot in last 30 years
most economists → - now view is that only short-run tradeoff
- contraversial theory: gov policy always
ineffective if anticipated
→ - supply shocks can shift curve
→ - stagnation not just b/c bad gov policy
51

5.1.2.1 Michael Plasencier 12/1



ACTIVITY 20

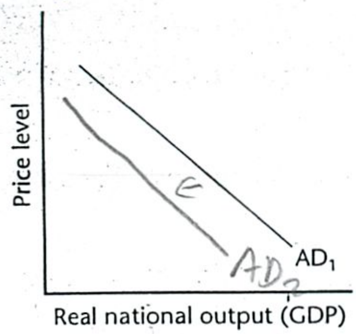
# Manipulating the AD/AS Model: Exogenous Demand and Supply Shocks

80

### Part A. Exogenous Demand Shocks

Read the description of each exogenous shock to aggregate demand and then draw a new AD curve that will represent the change caused by the demand shock. Label the new curve $AD_2$. Then briefly explain the reason for the change in the graph.

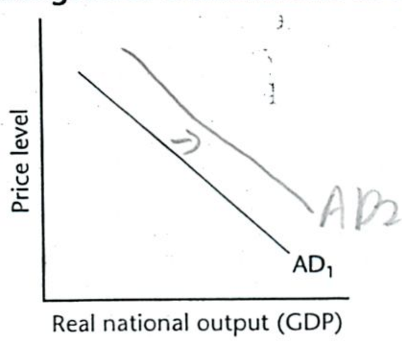
1. **Exogenous Demand Shock A**




EXOGENOUS SHOCK A:
General Motors lays off 30,000 workers.

EXPLANATION: Less people working means they have ~~less to~~ spend (no income) + cut back on purchases

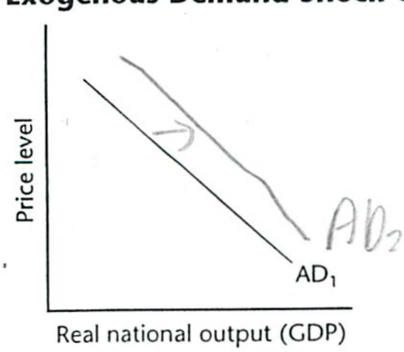
2. **Exogenous Demand Shock B**




EXOGENOUS SHOCK B:
Economic booms in both Japan and Europe result in massive increases in orders for exported goods from the United States.

EXPLANATION: Greater net exports

3. **Exogenous Demand Shock C**

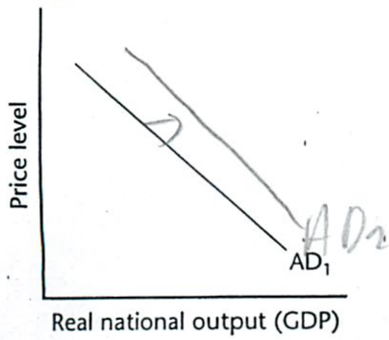



EXOGENOUS SHOCK C:
As part of its countercyclical policy, the government both reduces taxes and increases transfer payments.

EXPLANATION: Give consumers + businesses more $ to spend. ↓Taxes = ↓ leakages

C + Ig + G + Xn

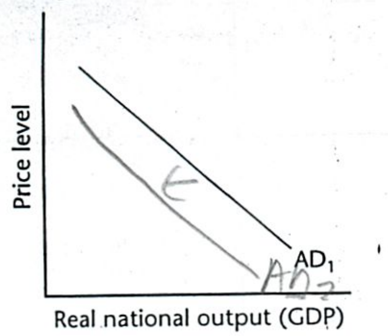
4. **Exogenous Demand Shock D**




EXOGENOUS SHOCK D:
While the United States was in the midst of the Great Depression, a foreign power attacked. Congress declared war and more than 1,000,000 soldiers were drafted in the first year while defense spending was increased several times over.

EXPLANATION: Even though are less consumers, Gov spending makes up for that.

5. **Exogenous Demand Shock E**

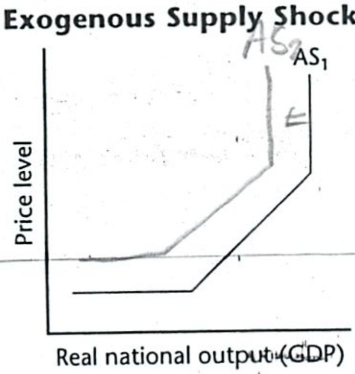



EXOGENOUS SHOCK E:
In order to balance the budget, the federal government cuts Social Security by 10 percent and federal aid to education by 20 percent.

EXPLANATION: Less Gov spending

**Part B. Exogenous Supply Shocks**
Read the description of each exogenous shock to aggregate supply and then draw a new AS curve that will represent the change caused by the shock. Label the new curve $AS_2$. Then briefly explain the reason for the change in the graph.

1. **Exogenous Supply Shock F**



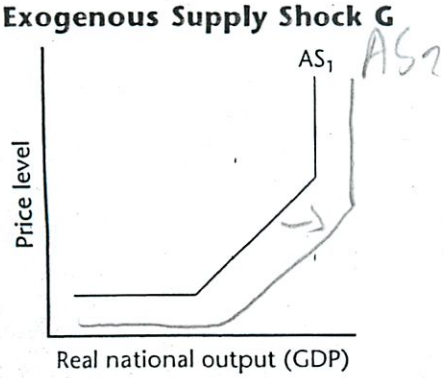

EXOGENOUS SHOCK F:
New environmental standards raise the average cost of autos and trucks five percent.

EXPLANATION: higher production costs ↓ production

 5|, 2, 3

## ACTIVITY 20 continued

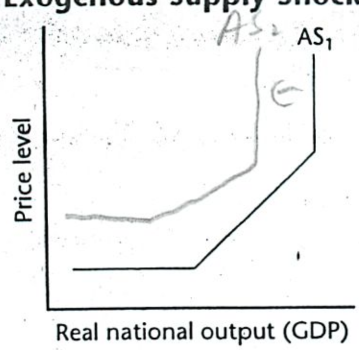
2. **Exogenous Supply Shock G**




EXOGENOUS SHOCK G:
Fine weather results in the highest corn and wheat yields in 40 years.

EXPLANATION: Nature has had a high ~~p~~productivity

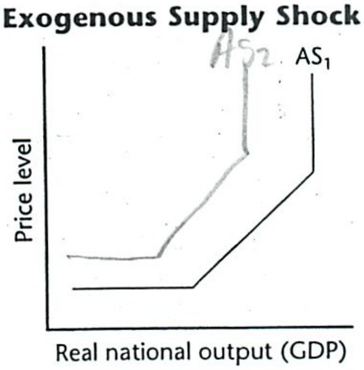
3. **Exogenous Supply Shock H**




EXOGENOUS SHOCK H:
Due to decreased international tensions, the government sells off thousands of Army surplus Jeeps and trucks at prices that are far less than the market price for their commercial counterparts.

EXPLANATION: Privates Businesses will recive less orders

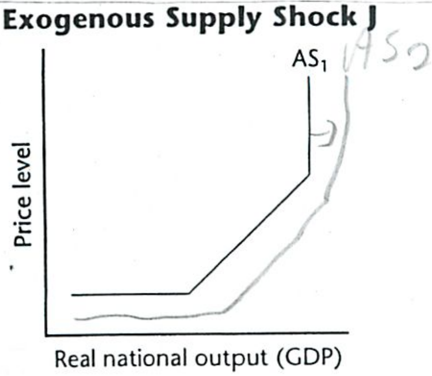
4. **Exogenous Supply Shock I**




EXOGENOUS SHOCK I:
An enemy power mines the sea lanes leading to the United States, and most ships refuse to deliver cargo through the mined areas.

EXPLANATION: Resources Prices ↑ b/c less coming in

5. **Exogenous Supply Shock J**




EXOGENOUS SHOCK J:
After a long war, many ships, planes, trucks, and trains that had been commandeered for military use are returned to their civilian operators.

EXPLANATION: They are now avalible again (unless you are talking about new orders)

?

still considered to be entering the economy

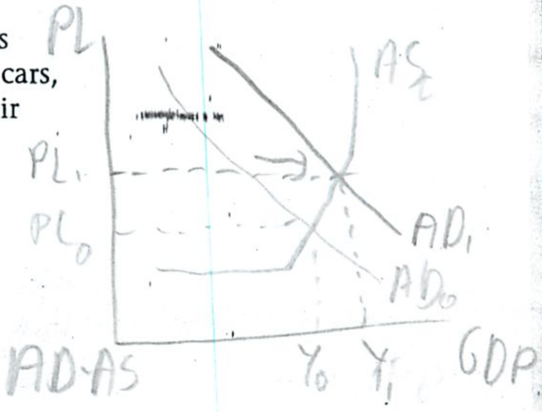
 51, 2, 4

# ACTIVITY 20 continued

**Part C. Manipulating the Aggregate Supply and Demand Model**

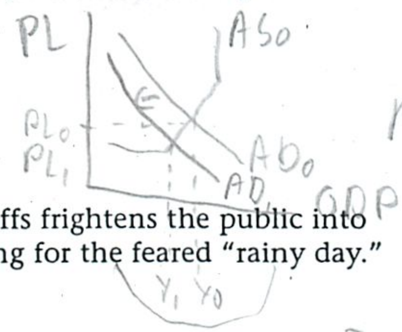
Read each of the scenarios below and explain the impact the exogenous shocks will have on aggregate supply and demand. Then draw an aggregate demand and aggregate supply diagram to illustrate each impact.

1. During a long, slow recovery from a recession, consumers postponed major purchases. Suddenly they begin to buy cars, refrigerators, televisions, and heating units to replace their failing models.



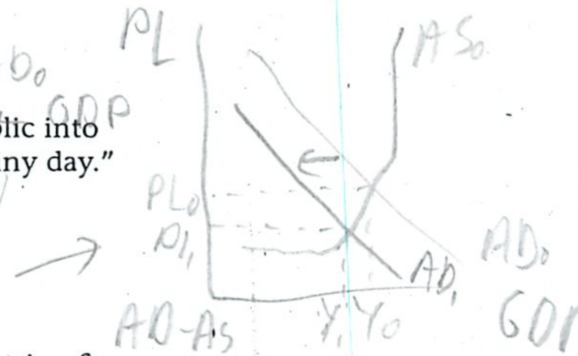

1Y

2. With no other dramatic changes, the government raises taxes and reduces transfer payments in the hope of balancing the budget.



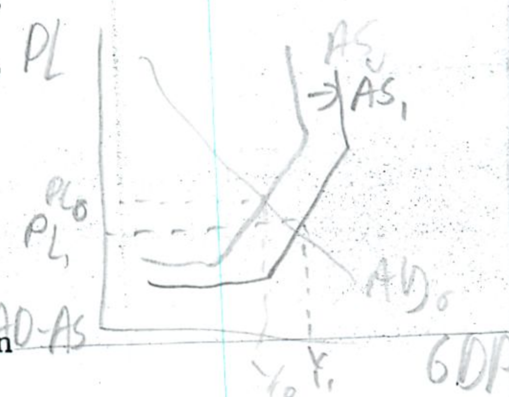

1X

3. News of possible future layoffs frightens the public into reducing spending and saving for the feared "rainy day."



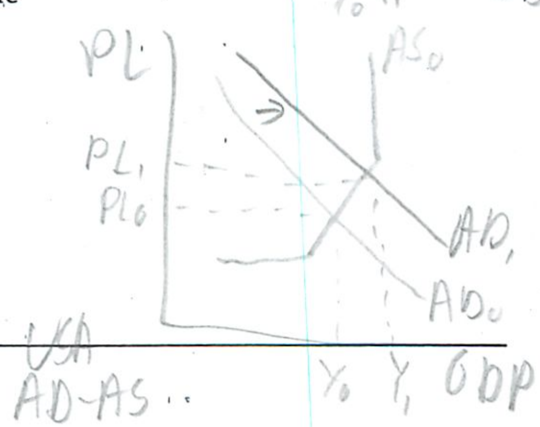

1Y

4. Due to rising tensions in many developing countries, firms begin to build new factories in the United States and to purchase sophisticated machinery that will enable them to produce here at prices that are competitive with those of low-salaried foreign countries.




1Y

5. Brazil solves its foreign debt and inflation problems. It then orders $10 billion worth of capital machinery from the United States.




1Y

51, 2, 5

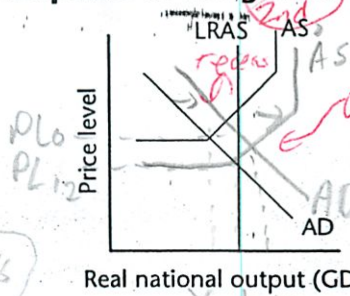
## ACTIVITY 20 continued

**Part D. Responses to All Shocks (Short-Run and Long-Run)**
Read the description of each exogenous shock to aggregate supply and aggregate demand and draw a new AS or AD curve that represents the change caused by the shock. In some cases, several curves may be shifted. Then explain the reasons for the change in the graph and the effects of the change on the economy.

1. EXOGENOUS SHOCK K:
Several Japanese firms open large plants in the United States.

EXPLANATION: More firms means higher productivity, ? does that mean LRAS shifts yes then ↑ wages means less supply ← ??

**Response to Exogenous Shock K**



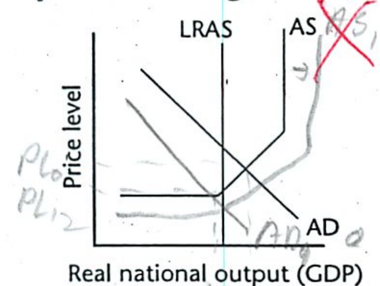

✓ AS won't shift until AS shift to past LRAS (3rd)

AD₁ ← to build plant = I+ (1st)

2. EXOGENOUS SHOCK L:
In order to lower inflation, the government raises personal income taxes by 20 percent.

EXPLANATION:
↓ AD b/c taxes ↑
? how does this shift AS
- Reduced PL may ↓ wages = ↑ AS back to normal Y at ↓ PL

**Response to Exogenous Shock L**

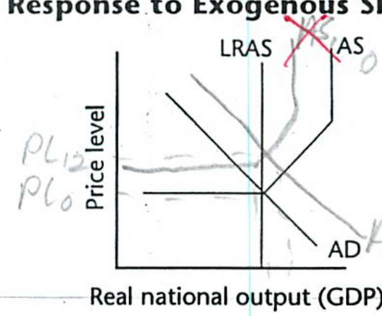



1x

3. EXOGENOUS SHOCK M:
The government increases defense spending by 10 percent per year over a five-year period.

EXPLANATION:
↑ G = ↑ AD
? how does this shift supply ~~more people employed~~ ??
~~increased PL~~
means ↑ wages which ↓ AS
So in the end ↑ PL w/ — Y

**Response to Exogenous Shock M**




1x

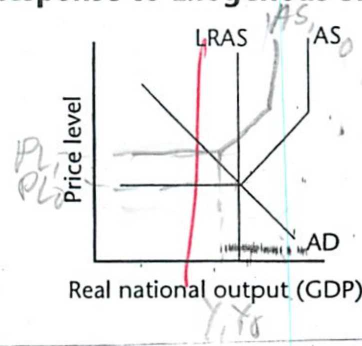
✓ Yup

4. EXOGENOUS SHOCK N:
OPEC cuts production by 30 percent, and the world price of oil rises by 40 percent.

EXPLANATION:

Supply-shock inflation brings up policy qu - do they start inflation spiral

**Response to Exogenous Shock N**




1x

5. EXOGENOUS SHOCK O:
The government announces a "War on Poverty" and increases spending on education, health care, housing, and basic services for the poor. No increase in taxes accompanies the program.

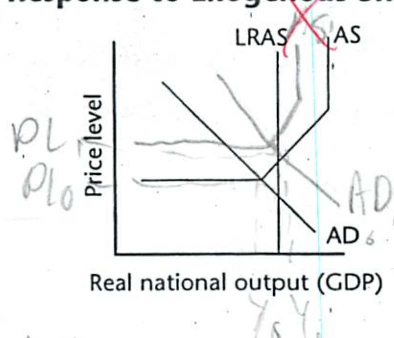
EXPLANATION:

↑AD, ↑ Output + ↑PL

wage increase wanted = ↓AS

↑PL w/ no change Y

**Response to Exogenous Shock O**




1x

51, 3, 1

Michael Plourmier

# Titanic Metaphor

12/1

Stabalization policies may not be inacted in time to change the carse of the ship. It takes time to slow the economy, like it does to slow the ship. Even in the end, the policy may not be effective to avoid disaster just like the ship hitting the iceberg

52, 1, 1

# Supply-Side Economics

12/3

20 Supply-Side Economics

beliefs
- changes in AS must be recognized as active forces in determining inflation + unemployment
- both AS + AD affects econ
- certain gov policies have ↓AS
- by reducing ↗ policies US econ can have ↓unemp. w/ inflation

23 Tax Transfer Disincentives

the growth of US tax system harm's people's willingness to work
errodes productivity
+ slows long run AS growth
marginal tax rates are relavant (!)

25 Tax + Incentives to Work

how long + hard you work is dependent on after tax earning's
gov should ↓ marginal tax rate
- makes add. work more attractive

Transfer Disincentives

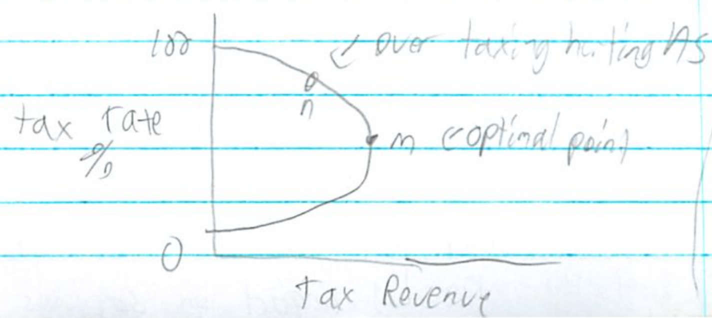
28 transfer programs errode willingness to work
job loss is not as expensive
but work req. are starting to be added

Incentives to Save + Invest

high marginal tax rate errode a lot of savings
they want ↓ tax on investments

31 Laffer Curve

↓ marginal tax rate = ↑AS
also Arthur Laffer says that ↓ tax rates ≠ ↓ tax revenues




if tax rate = 100% people would do nothing + revenues would be 0$

52,1,2

were at point N in early 80's See below
~~teacher, can't tell where point N is or where on curve we are~~
35 less tax evasion
tax evasion + avoidence ↓ with ↓ tax rates
↓ tax rates will make it less nessory to avoid tax
reduced transfers
↓ tax rates = ↑ production = ↑ unemployment = ↓ transfer payments = ↓ gov budget deficits

38 Criticisms of Laffer Curve
Taxes, Incentives, + Time
critics say impact of tax cut is small + slow
some people even work less b/c ↓ taxes = ↑ wages
= more $ to spend on leisure
others tax advantage to make more $
40 Inflation
most economists think D effects > S effects
tax cuts near $Q_F$ would ↑ AD more then AS
causing demand pull inflation
42 Position on the Curve
no way of knowing where on curve we are
might make wrong move

43 Over regulation
Industrial Regulation
gov lets monopolies is some areas ↓ competition
Social Regulations
45 pollution, saftey + = opportunity employment ↑ input prices
Reaganomics
Regan (81-88) belived in this
did have long periods of expanison w/ ↓ rates + inflation
but it did little to ↑ AS
48 no big impact on savings or incentive to work

52, 1, 3

00 - most economists say good times was b/c demand effects from ↓ taxes
- left high buget deficits we are still dealing with

- so in the end supply side theory didn't work well when Regan tried it

02 Last Word: Price + Wage Control
why not just outlaw wage + price ↑ ?
every time controls lost + inflation won
tried several times
1. Controls for symptoms, not causes
inflation cased by ↑$ suppy, ↑ investment spending, or ↑ supply shock
05 2. Circumvention Problems
people try to get arround them
cause shortages
↳ black market then marks them ↑
might ↓ quality
might change job titles
07 3. inability to maintain public support
public that wants them change their mind when they realize effects
4. Allocative Inefficincy + Rationing
can't respond to allocative changes
08 can't ration well (w/ price)

ACTIVITY 49

# Supply-Side Economics, Budget Deficits, and Tax Changes

When Ronald Reagan took office in January 1981, inflation was high (12.4 percent in 1980), and unemployment was high (7 percent in 1980). President Reagan argued that we needed a new approach to our economic problems. Because the new approach called for us to change our focus from the effect tax cuts had on demand to the effect tax cuts had on supply, the new approach was labeled *supply-side economics*. The argument of supply-side economics was that if the marginal tax rate on income from wages, interest, and profits were reduced, it would stimulate work efforts, savings, and investment so that we would have both an increase in employment and a decrease in inflation. Taxes were cut in 1982, but the Federal Reserve simultaneously pursued a very contractionary monetary policy. The Fed's contractionary monetary policy was stronger than the expansionary fiscal policy, so the economy experienced a severe recession. Unemployment was 9.5 percent in both 1982 and 1983, and it was not until 1985 that unemployment returned to its 1980 level of 7 percent. With some help from falling oil prices, this severe and prolonged recession did bring down inflation; measured by the CPI, inflation was less than percent in 1986. When Reagan left office in 1988, the unemployment rate was 5.5 percent, and the rate of inflation was 4.4 percent. In 1988, real GDP increased by 3.9 percent, rising for the sixth straight year.

With inflation at a more reasonable level, the federal budget deficit became the focus of economic policy. In 1981, the budget deficit was $74 billion but rose to over $221 billion by 1986. Some taxes were raised as part of the tax reform package in 1986, and by 1989 the budget deficit was down to $152 billion. By 1990, however, the budget deficit had grown again to $221 billion. This prompted President George Bush and the Democratic Congress to raise taxes in 1990.

After eight consecutive years of growth, the economy hit the skids. In 1992, real GDP decreased 1.2 percent; the unemployment rate increased from 5.5 percent in 1990 to 7.4 percent; and the budget deficit rose to $290 billion. Only inflation stayed low, at about 3 percent. Low inflation was not good enough. The voters replaced Bush with Bill Clinton.

President Clinton and the Congress increased taxes and reduced the growth of federal expenditures. By 1994, the budget deficit stood at $234 billion; unemployment had fallen to 6.1 percent; and real GDP was rising at about a 4 percent annual rate. Nevertheless, the voters elected a Republican majority in the House of Representatives and the Senate in 1994. People wondered, in 1996, would Clinton join Bush as a one-term President? Would the state of the economy or other issues decide the election of 1996?

Answer these questions on a separate sheet of paper.

1. Use an AD/AS diagram to explain the supply-side argument that tax cuts would increase employment and reduce inflation.

2. Explain how an expansionary fiscal policy combined with a contractionary monetary policy affects the interest rate. Does this help to explain the argument that the current budget deficit hurts investment and growth? Explain.

3. a. If we consistently use fiscal policy to get the economy out of a recession and monetary policy to cool the economy down when inflation becomes a problem, what happens to the interest rate over time? to the budget deficit? to growth in potential output? Explain.

52,3,2





b. Does this make the discipline of a balanced budget more meaningful? Explain.

4. How would a Keynesian explain why the tax increase in 1990 would result in lower real GDP, higher unemployment, and a lower rate of inflation? Use an AD/AS diagram to illustrate this.

5. Harvard economist Robert Barro believes that President Bush was responsible for the poor economic performance in the latter half of his administration. According to Barro*:

> Free-market policies worked well in the United States in the 1980s and in other places at various times, so we apparently have decided to try something else.... Bush raised taxes and spending, increased the minimum wage rate and unemployment-insurance benefits, intensified the enforcement of regulations, and enacted an array of new intrusions in the form of the Americans-with-Disabilities Act, the Clean Air Act, and the Civil Rights Act.

a. Is this a supply-side or a demand-side argument? Explain your answer.

b. Illustrate this with an AD/AS diagram.

c. Barro writes that inflation didn't increase because of "a monetary policy that remained committed to low inflation."* What would this monetary policy have to be in order to keep inflation low? Would it be a tight money or easy money policy?

6. a. Did President Clinton's policies work? Why or why not?

b. At the time you are reading this, what are the growth rate in real GDP, the unemployment rate, and the inflation rate?

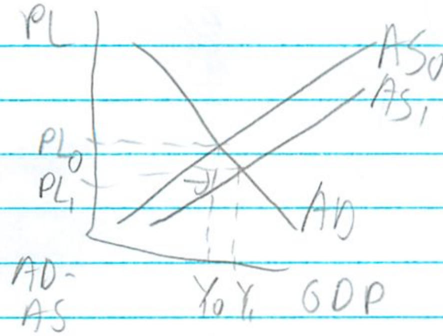


*Robert J. Barro, "Issue: Clinton's First-Year Economic Report Card," *The Senior Economist*, Vol. 9, No. 4, Apr. 1994, p. 8.

52.3.3

# Activity 49

12/4

1. 


Tax cuts ↑ AS because there is more incentive to work. This ↓ Inflation + ↑ Output

+ also increase AD

or crowding out if by gov

Gives people more $ to invest

↓ does it?

monetary policy

2. Expansionary fiscal policy puts more $ into society by collecting less taxes. ~~This ↑ the $ supply~~ ↑ interest rates. Meanwhile a contractionary policy ↓ $ supply which raises price ↑ rates. This hurts investment + growth ~~if the contractionary policy is stronger~~ b/c both ↑ interest rate

- contradictory policies

3. ↑ Inflation would always happen. The interest rate would go ↑ and ~~↓~~ but ~~end up with~~ always a net ↑ gain. The budget deficit would grow because there is no contractionary monetary policy to pay it off. The output would grow but investment held back at another.

↑ at ↓ point

always ↑ savings + invest

both ↑ interest rate

↑ fiscal = ↑

↑ investment = ↑ rate

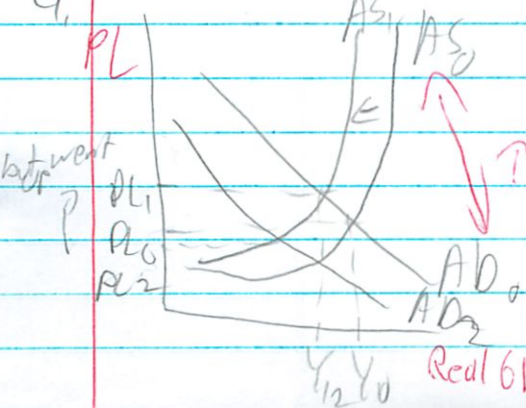
↓ monetary = ↑ interest rate

?

Yes you don't want to run up a deficit b/c inflation

b. ~~No~~ a balanced budget requirement is bad. But crowding in the above, there is no way to pay it off, so out effect mabey it comes into play ↑ interest rates - Should pay off deficit in prosperity

← investment in future will ↓

4. 


↑ taxes, reduce spending (AD) and ↑ input prices ↓ AS. This means both output + PL ↓

↑ + lower both

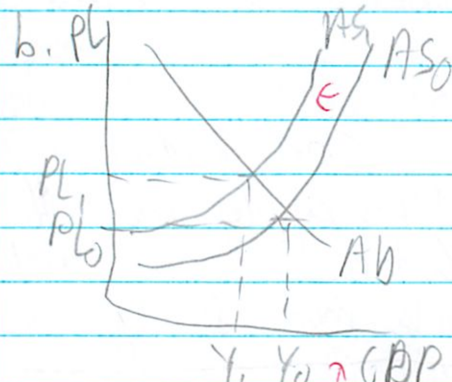
↑ AS won't shift according to keynes

↓ would also shrink

52, 3, 4

5. a Supply side - these are costs to businesses

b.




c tight $ to ↓ investment - only increase $ supply w/ rate of growth

6. It seemed to have worked till the new Bush came to mess it up.

↑ taxes did help ↓ deficit

2.3% growth
4.4% unemployment
1.3% inflation

52,4,1

The New York Times
nytimes.com



**December 1, 2006**

OP-ED COLUMNIST

# Economic Storm Signals

**By PAUL KRUGMAN**

"It's tough to make predictions," Yogi Berra is supposed to have said, "especially about the future." Actually, his remark makes perfect sense to economists, who sometimes have trouble making predictions about the present. And this is one of those times.

We're now two-thirds of the way through the fourth quarter of 2006, so you might think we'd already know how the quarter is going. Yet, economists' assessments of the current state of the U.S. economy, never mind the future, are all over the place.

And here's the bad news: this kind of confusion about what's going on is what typically happens when the economy is at a turning point, when an economic expansion is about to turn into a recession (or vice versa). At turning points, the various indicators that usually tell us which way the economic wind is blowing often point in different directions, so that both optimists and pessimists can find data to support their position.

The last time things were this confused was early in 2001, when most economists failed to realize that the United States was sliding into recession. If that sounds ominous, it should: the bond market, which has a pretty good record of forecasting recessions, is pointing toward a serious economic slowdown next year.

Before I explain what the bond market is telling us, let's talk about why the economy may be at a turning point.

Between mid-2003 and mid-2006, economic growth in the United States was fueled mainly by a huge housing boom, which created jobs directly and made it easy for consumers to spend freely by borrowing against their rising home equity.

That housing boom has now gone bust. But the optimists and pessimists disagree both about how bad the bust will get and about how much damage the housing slump will do to the economy as a whole.

52, 4, 2

The optimists include Alan Greenspan, whom some accuse of letting the housing bubble get out of hand in the first place. On Tuesday, he told investors at a conference that the worst of the housing slump is over, saying that "it looks as though sales figures have stabilized."

But the very next day the government released grim data on new home sales for October, and revised its estimates for earlier months downward. Most, though not all, of the other economic numbers that came out this week were also substantially weaker than expected.

Pessimists feel vindicated by the downbeat data. Nouriel Roubini of Roubini Global Economics, who has been forecasting a housing-led recession for some time, now believes that the economy has already stalled: he predicts zero growth for the current quarter. Economists at Deutsche Bank say the same thing.

But that's still a minority position; most forecasters are still telling us not to worry. So whom should you listen to? And how can you avoid believing what you want to believe?

Maybe the best answer is to look at what the financial markets say. Not the stock market, which is a notoriously bad indicator of the economy's direction, but the bond market. (Paul Samuelson, the Nobel Prize-winning M.I.T. economist, famously quipped that the stock market had predicted nine of the last five recessions). inverted yield curve

Since last summer, when the housing bust became unmistakable, interest rates on long-term bonds have fallen sharply. They're now yielding much less than short-term bonds. The fact that investors are willing to buy those long-term bonds anyway tells us that these investors expect interest rates to fall. And that will happen only if the economy weakens, forcing the Federal Reserve to cut rates. So bond buyers are, in effect, betting on a future economic slowdown.

How serious a slump is the bond market predicting? Pretty serious. Right now, statistical models based on the historical correlation between interest rates and recessions give roughly even odds that we're about to experience a formal recession. And since even a slowdown that doesn't formally qualify as a recession can lead to a sharp rise in unemployment, the odds are very good — maybe 2 to 1 — that 2007 will be a very tough year.

Luckily, we've got good leadership for the coming economic storm: the White House is occupied by a man who's ideologically flexible, listens to a wide variety of views, and understands that policy has to be based on careful analysis, not gut instincts. Oh, wait.

? of course not!

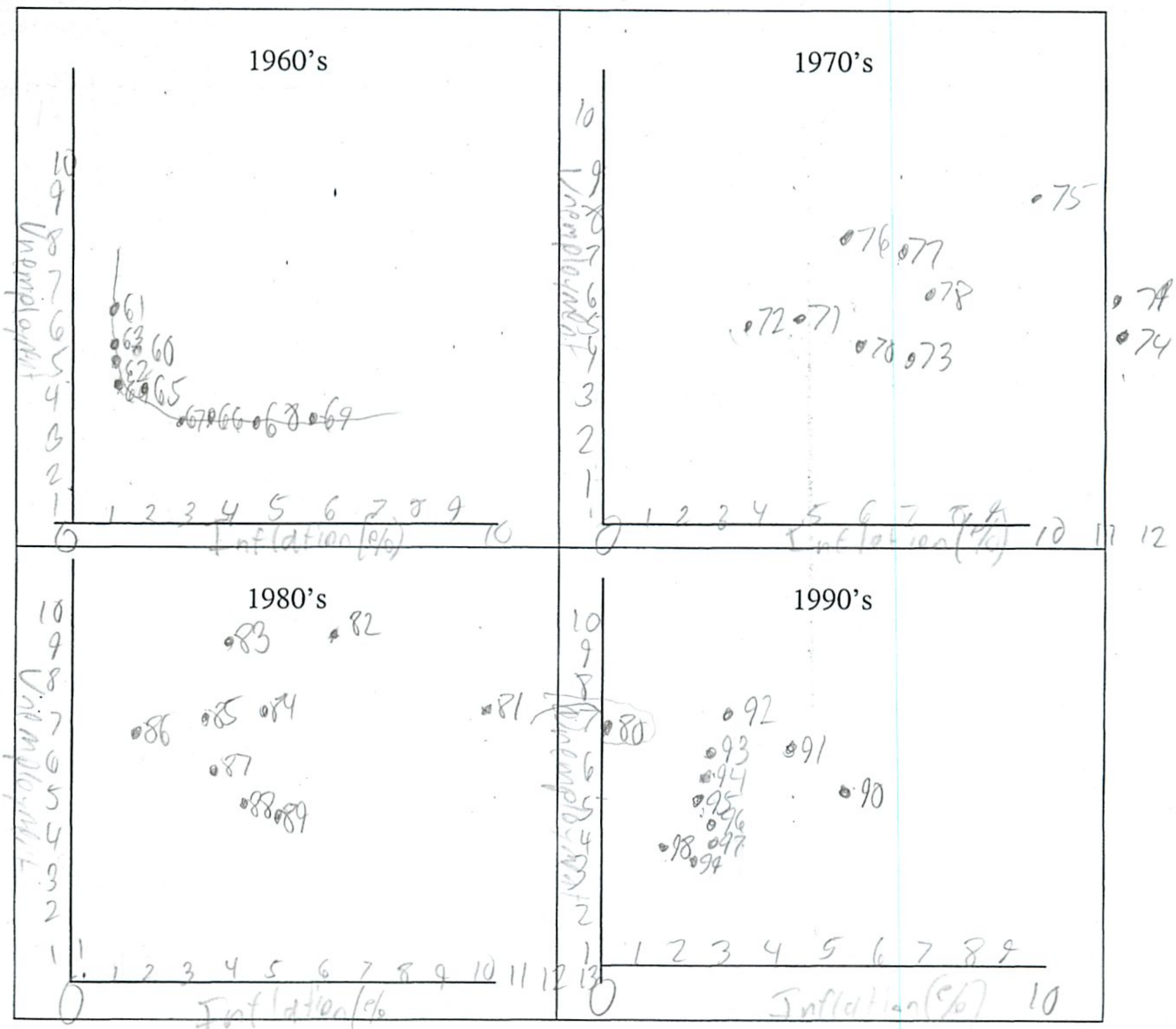
51, 5, 1

Michael Plasmeier +5

## Web Activity 17 The Philips Curve-Does It Hold?

Ideally we would like to achieve low unemployment and low inflation at the same time. Often that is not possible, because as unemployment drops, incomes rise and consumer spending increases. Sellers see that demand is up and then raise prices, which leads to inflation. Inflation can arise from the supply side also. As the demand for labor increases with low unemployment, wages rise causing firms to raises ~~prices~~ to cover the increased costs of production.

The Philips curve illustrates the relationship between inflation and unemployment. For the decades of the 1960's, 1970's, 1980's and the 1990's, plot the unemployment rate and inflation rates from data you will find at www.bls.gov Put the unemployment rate on the vertical axis and the inflation rate on the horizontal axis. Is there always an opposite relationship between the two? No, the curve shifts with supply



53,1,1

# Macro Economic Disputes

12/5

36 History; Classics + keynes
Classical View
econ best if left alone
1800s
AD downsloping + totally establishes PL
★ AS vertical
- at $Y_F$ (also full capacity output)
38 - because Says Law + flexible prices
↑production creates its own demand
- not slopped b/c input prices Δ along w/ # produced
real profits don't change, so producers don't
41 make more $ if they ↑$
AD stable
depends on quant of $ consumers have + the $'s
purchasing power
curve slopes b/c ↓ PL = ↑ consumption (?)
★ AD will remain stable is $S —
44 ★ (?) need to control $S to keep AD stable
★ doesn't take into account ↓ production = ↓ employment
= ↓ A Consumption = ↓ AD — opps :)

45 Keynesian View
★ core is; prices are ↓ward inflexable over time
(??) so AS is horzontal (to $Q_F$)
why no ↑ PL Δ or Δ AS
decline in real output has no effect on PL
once $Q_F$ reached — AS = vertical
AD unstable
investment particulry is instable
gov policies is to ↑ AD to $Q_F$
- otherwise we are wasteful
51 ⟶

53, 1, 2

What causes Macro instability?
Mainstream View
Keynesian based
54 Change in Investment Spending ↓
$GDP = C + I_g + G + X_n$
investment is most volitale component
-subject to booms + busts
-magnifies them
Adverse AS shocks
external events or price controls affect
↑ imput prices = ↓ AS = ↑PL $\pm$ ↓ Y

57 Monetorists View ✓Milton Friedman
3 key beliefs
focuses on $ supply
markets are very competitive
the competiveness gives macro stability
Δ prices affect resource prices not output
*** gov's interference is root of all instability
-promotes ↓ wage inflexabity
-allows monopolies
00 -gov contributes to bis cycle by "helping" econ
Equation of Exchange
$MV = PQ$ ← quantity goods produced (nominal GDP)
↑ money ↑ velocity — Price level
spent recieved
* volume of spending = volume of output
03 Stable velocity
thought velocity is stable (not constant)
higher today ten years ago
changes slowly + predictably
doesn't change w/ $ supply

5 3, 1, 3

Friedman
no discretionary use of $ b/c lags in econ
3 types
recognition
polic 7
implementation

05 if too much $ - the econ can't get rid of it
- just gets respent
- so in the end AD ↑ + GDP $\frac{GDP}{M} = V$

07 - must therefore be stable relationship b/w

Monetary Causes of Instability
inappropriate monetary policy is biggest cause
too much $ = ↑AD in vertical range = inflation
- when natural rate catches up

09

Real B-Cycle View
flucations are b/c tech + resource Δ
↑ supply increase not b/c spending + monetary policy
new tech ↑ productivity = ↑ output = ↑ $D = ↑AD
- by amt = to LRAS Δ
12 on the supply side not demand side

Coordination Failures
- people don't go to mutually benifitial equalibrium
14 b/c they can't coordinate actions
- if everyone thinks will be a ↓A spending → AS ↓
as investment ↓ + households' savings ↑
- econ will ↓ due to self-fulfilling prophecy
16 - however all will not agree to ↑ spending

↑ Market Systems
better than command (communism)
systems

54.1.1

# Self-Correction? Notes

12/6

59 Does the econ self-correct?
- and if so, how long does it take?
- New Classical View
  - monetarists + rational expectations followers
  - we will auto move back to $Q_F$
  - 03/13 like the adaptove, rational + natural rate theories
  - 13 → same long range effect as before
  - Speed of Adjustment
    - monetarists usally say people have adaptae expectations
    - so it might be 2-3 or more years
    - however if rational expectations - moves quickly (RET)
      - People gater + research changes
      - beliefs accurately relfly llikly-hood it will occur.
      - unantaicipated (suprise) PL changes do Δ output
        - try to make profits → causes manfacturs to ↑ output of their product
        - 18 all prices rise and manu. ↓ output again
      - fully anticipated Δ
        - don't change output at all
        - if AD ↑ they just ↑ Price
        - profits stay the same
- Mainstream View
  - 21 new classical view has impacted this theory
  - though they think prices can't shift ↓ well
  - may take years to recover from inflation
  - output just ↓ in depressions
  - highy unlikly wages are affected by Δ PL
    - short AS won't shift rightward
  - 27 self correcting model breaks down
  - Downward Wage Inflexabilty
    - Unions + min. wage stop wage ↓
    - might ↓ morale, retention, efficiency + effort

54, 1, 2

28 Efficiency wage theory
minimizes labour cost per unit of output
normally market wage
but sometimes (high turnover) actually more efficient to pay workers more
greater work effort
- $\uparrow$ cost of losing job
- want to retain more

31 lower supervision costs
b/c of less shirk
reduced turnover
$\downarrow$ cost of hiring + training workers
makes it harder to $\downarrow$ wages

Inside/Outsider Relationship

33 insiders - keep working through depression
outsiders - laid off when recession
outsiders should try to lower their wages to keep their job
but the cost of hiring might be too $\uparrow$
also insiders don't like this
- might $\downarrow$ teamwork
outsiders might not want pay cut

self correction will eventually happen but not as
35 fast as classicals say

 54, 2, 1

ACTIVITY 22

# Full Employment in a Capitalist Economy

A capitalist economy is capable of automatically achieving and sustaining a full-employment level of output. Business-cycle fluctuations are temporary abnormalities induced by external factors such as wars, political changes, natural disasters, or gold rushes. Left alone to adjust after one of these events, the capitalist economy will automatically return to the norm of full employment. really ?

Fundamental to the belief that a capitalist economy can maintain a full-employment level of output is Say's Law, the idea that "supply creates its own demand." If aggregate demand, tied to the money supply and relatively stable, is temporarily deficient, the economy has only to produce output to maintain employment, According to French economist Jean Baptiste Say (1767–1832), the act of producing output generates the exact amount of income necessary to purchase the output, thus creating its own demand.

In the event that some income is not spent on consumption, the adjustment mechanism of interest rates in the money markets of the economy will equate the leakage of saving with an injection of investment. This automatic return of savings into the economy through the vehicle of investment will be sufficient to maintain the level of expenditures necessary to purchase the output produced. If consumers save more, interest rates will fall and businesses will invest more. If saving declines, interest rates will rise and business investment will decline. Therefore, the mechanism of interest rates will maintain an equilibrium between saving and investment, allowing the level of expenditures to remain stable.

Another inherent mechanism in a capitalist economy that helps to achieve and sustain a full-employment level of output is downward price and wage flexibility. If aggregate demand were to fall, prices and wages would also fall. As the price level declines, the purchasing power of consumer dollars would rise; therefore, a lower wage coupled with increased purchasing power of the dollar would combine to maintain real incomes of the consumers. Because wages (a cost of production) fall along with prices, businesses would be able to maintain the same amount of output and employment as before and still receive the same level of profit in real terms.

The above analysis is supported by a *vertical* aggregate supply curve located at the full-employment level of output. Changes in aggregate demand, caused by external factors, shift the aggregate demand curve up or down the vertical aggregate supply curve. In each case, full-employment output is sustained due to the self-regulating mechanisms (interest rates and wage-price flexibility) inherent in the economy. Because the economy is capable of correcting itself and maintaining a full-employment level of output, there is no need for government intervention in the economy. In fact, government involvement may prevent the self-regulating mechanisms from fulfilling their roles, thus causing instability in the economy.

- Only 1 view

## ACTIVITY 22 continued

Questions for small group discussion:

1. Do business cycle fluctuations occur as a result of external or internal factors? Explain.
2. Are periods of economic instability temporary, or can they be of long duration?
3. Identify and explain the main determinant of the level of output and employment in the economy.
4. If people save their income instead of spending it, what will be the effect on the level of output and employment? Will interest rates automatically equate the leakage of saving with an injection of investment spending by business firms? Explain why or why not.
5. Are wages and prices downwardly flexible in the event of decreases in aggregate demand? Explain why or why not.
6. Does a capitalist economy contain inherent self-adjusting mechanisms that assist it in achieving and sustaining full-employment levels of output?
7. What should be the proper role of government in the capitalist economy? Explain why.
8. Describe the shape of the aggregate supply curve. Illustrate how the shape of the AS curve explains, in the event of changing aggregate demand, the conclusion drawn in question 6.

54, 2, 3

Act 22

12/7

1. External, The article takes the view that econ will correct itself if internal changes happen, External changes causes these fultuation

2. Temp, Again the econ will bounce back from any instability

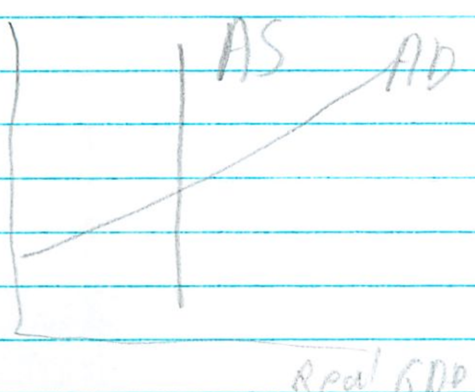
3. External fluctations not internal demand changes, Demand will change itself to the supply, Not the other way around.
   - My whole group disagrees - They think its demand
   Demand creates own supply - paper seems to support that

4. ↓S = ↑I this maintains the same demand, If consumers save more IR↓ → ↑Investment, Yes, they believe that the economy is self correcting

5. The classical school belives wages + prices are down-wardly flexable (5th line coloum 2) Employees + resource supplies would ask for a reduction to keep their job

6. Yes, that is what the entire article believes

7. To stay away and let the self-correcting mechnisms work.

8. 


No matter how much is demanded profits will be the same and the real amount produced will be the same.

?

55.1.1

Rules/Discretion

12/7

Rules + Discretion?

no action

09 should gov follow policy rules or should it take action

Policy Rules

monetarists + new classical thinkers

gov should not try to manage AD

11 - causes more harm then good

26 Monetary Rule

leave alone otherwise

monetarists want it

would require Fed to ↑$s at same rate as GDP ↑

would shift w/ LRAs

would allow growth + PL stability

RET supports think

- monetary policy can Δ inflation but not output

- announcement by Fed of actions causes

30 preparations which hurt econ in long run

- so combo of rational expectations + instant action dooms monetary policy

Milton Friedman - Revived classical w/ monetarism

See 53.1.1

Balanced Budget

some want gov to not do fiscal policy

deficits + surpluses will auto correct themselves

really don't like expansionary because it crowds out private business

34 RET's also think it won't work

- we predict gov Δ + adapt to them

36 In Defense of Discretionary Stable Policy

57 relationship b/w GDP + $ supply only in long term

velocity of $ is more unpredictable

00 also ↑AD might ↑expectations which ↑I

don't think overcrowding is a problem

balanced budget would hurt recessions + expansions

55.1.2

02 Increased Macro Stability

- US econ has been $\frac{1}{3}$ more stable since 1946
- b/c, they say, of monetary + fiscal policies
  - helped ↓ inflation in early 80's
  - reduceded unemployment mid 80's
  - helped recover after 1990-91 recession
  - helped econ grow (w/o inflation) in mid 90's

04 Summary of Alt. Views

| Issue | Mainstream (Keynesian) | Monetarism | Rational (newclassical) | Supply-side |
|---|---|---|---|---|
| Private econ | potentially unstable | stable in long run at $Q_F$ → | | may stagnate w/o incentives |
| Cause of private econ instability | Investment Plans ≠ Savings (ΔAD) AS shocks | Inappropriate monetary policy | Unanticipate AD + AS shocks | ΔAS |
| Appropriate macro policies | Active fiscal + monetary policy | monetary rule | monetary rule | ↑AS |
| How Δ$S effects econ | ΔIR → ΔI → ΔGDP | directly ΔAD which ΔAS | no Δ in output b/c PL Δ anticipated | ↑I and therefore AS |
| Velocity $ | unstable | stable | no concsensus | no consensus |
| fiscal policy effects | ΔAD + GDP via multiplyer | no Δ unless $S Δ | no Δ ouput b/c PL Δ anticipated | affects GDP + PL via AS |
| Cost-push inflation | possible (wage-push, AS shock) | Impossible in LR w/o excessive $S ↑ → | | Possible tax-transfer ↑cost w/ regulati |

12

Last word tmo

16

56.1.1

# Growth Notes

12/10

04 Chap 17 Last Word: Profit Sharing
- to make wages more flexaple - why not share profits w/ employees
- workers guaranteed certain amt + then get extra
- wages ↓ in recession
- would makes wages less stable
* - would have to invest less in capital
  - capital is driving force of long term GDP growth
07 - employers may hide some profits
- only limited plans are going into effect

Economic Growth Intro/stats
USA grew 15 fold 1990 - 1996
- population only 3x bigger
- also goods are of a much higher quality
- but since the 70's growth slowed a lot

10 Growth Economics
examins factors which grow econ over time
2 definitions ( an increase in real GDP over time ← political power
an " " " " per capita over time ← standard of living

12 Growth as a Goal
widely held economic goal
↑ income + ↑ standard of living
* lessens the burden of scarcity
only if growth > pop Δ

Arithmetic of Growth
small Δ in growth makes big difference
some economists say growth more important than stability
? growth at 1 point gets multiplied bigger
16 every year

56,1,2

23 Ingredients of Growth

Supply Factors

$\uparrow$ in quantity + quality of natural resourses

$\uparrow$ in " " " labor + ent, skill

$\uparrow$ in supply of capital goods

$\uparrow$ in tech

all produce an $\uparrow$ of real output

Demand Factor

econ needs to fully use avalible resourses

Efficeny Factor

must use resourses in least costly way (productive)

must have right mix (allocative)

27 factors are related

-affect one anotor-

Graphical Analysis

Growth + Production Possibility

PP curve shifts outward when S $\uparrow$

but not untill AD $\uparrow$ or efficeny $\uparrow$ does the point we are on move to the right

30 Labor + Productivity

growth mainly on supply side

to $\uparrow$ output ( $\uparrow$ imput of resourses

$\uparrow$ productivity

* nations real GDP = imput of labor (hours) • labor productivity (real output / hour

determinants

labor

size of labor force

33 avg. hrs of work

productivity

tech advances - health - allocative efficeny

quantity of capital — other factors

34 education + training — motivation

56,1,3

35 labor-force participation rate
- % working-age people actually working

37 Extended AD-AS Model
38 long run AS + AD + AS move ⇒, increasing PL + Q
↑ in short + long run AS
- econs potental output ↑
↑ in AD
econ can only realize ↑ production possibility w/ ↑AD
(only if prices + wages ↓ inflexable)

42

Growth in USA
real GDP 6x since 1940
43 real GDP per person 3x since 1940
real GDP ↑ 3.1% annually
improvements in products + services
# don't count quality improvements
this understates economic well-being
added leisure
workweek only 40 hours from 50 hours
enviromental effects
dosn't count ↓ in enviroment
47 ✱ thus # overstate gains from growth
international comparisons
our growth record ½ of Japan
48 but countries with ↓ GDP grow quicker

56.2.1 Michael Plasmeier

# Chap 18 Study Questions

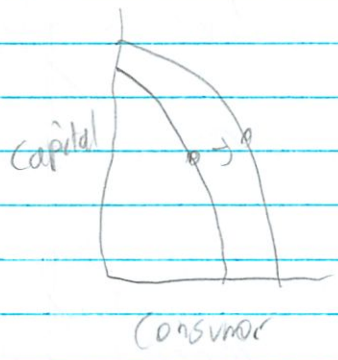
12/08

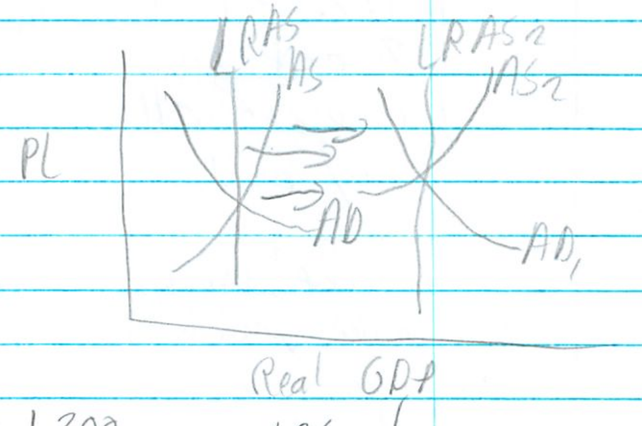
47

1. Growth is important because it increases the standards of living without sacrifice. It allows us to buy computers + feed the poor without trade-offs due to tech. advances. ↑ growth is important because it is compounded over time, making a small initial change easier to fix.

51

2. The 6 main ingredients of growth are ↑ in quant. + quality of natural + human resources, An increase in stock of capital goods and improvements in tech. Also added is the ↑ in demand + productivity or efficiency. A demand ↑ is also required or else the excess supply goes unused.

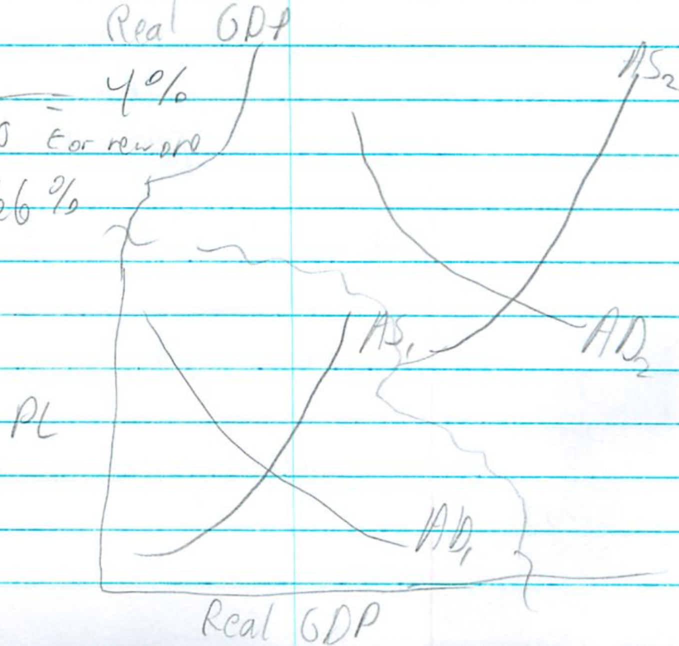



55

05 3. $\frac{31,200}{102} - \frac{30,000}{101} = \frac{1,200}{30,000} = 4\%$ (or reword)

305 300 → $\frac{5}{300} = 1.66\%$




10

56, 2, 2

10 4. The growth rate in the USA has been varried. It went ↓ in the GD, then spead up really fast during WW2 then continuing strong until the 70's where it slowed. During the baby boom of the early 50's Real GDP ↑ fast but per capital showed little change. Our growth after WW2 is much below Japan + Germany. However growth does not count always for Δ in living standards because quality + ecology are not adjusted for

slow reconversion

15

5. The growth in the economy is primarly from productivity increases. Next comes actual ↑ in the population working. Next at 28% is tech advances and 20% is because the quality of capital has gotten better. Education (human capital) comes in at 12% and tied for 8% comes economies of sale + resourse allocation. Lastly 9% is taken away because of gov. Regulations.

18

6. If someone works as a farm worker, they can not make much. However as a factory worker they are able to produce more (+ more valiable) goods. Thus an assembly line produces more output per amount of input.

20 7. As productivity ↑ workers are able to produce more. However they want to be paid more or they will go elsewhere with their labor. Inflation is most directly tied to labor prices so that will happen too.

$\frac{?}{2}$

22

56.2,3

19 8. There are many possible causes of the productivity slowdown of the 70s. Baby boomers + women were inexperienced because they had not planned long ago to join the work force. Test scores were down and people were getting less education. In addition R+D spending decreased and so did Investment. This may have been caused by the low savings rate driving up interest rates. Foreign competition and markets reduces spending on US capital. The ↑ regulation diverts extra $ and less infastructure discourages companies. The rise in energy prices increased the cost of opperating

23 capital.

I think this is behind us now. Energy prices are stable (when book written) R+D is back ↑ and interest rates are low while wages are rising. People are flocking to universities and new international markets are opening up. But greatest of all, the computer is a revolution in the way businesses work.

25

9. He means that growth is not always a smooth process. Investment spending diverts from consumer spending. Any changes at all upset plans. You must keep in motion. I think it is relevent for companies to know they must always innovate. Yes this causes problems now, but will help in the

7/2 future. Policy makers need to try + make the policy as smooth as possible by offering tax breaks + incentives

28 can't gauge demand well

quote: moderation - must prevent harm

56, 2, 4

28 10. a. True - computers are changing our world + will continue to do so - they are the main basis of productivity ↑ which is the basis of growth

b. False. The textbook states the oppset. Firms must be confident a good stable climate will exist for them. Democracy help give that support.

c. True - investment in roads brings companies along those roads

32 d. False - Other way arround, the service sector rellies more on humans and is less dependent on price because of consumer loyality + less foreign competition

33
51 11. ~~I would try to ↑D + ↑S by ↓ interest rates ↑ gov spending ↑ education ↑ consumption tax + b-taxes ↑R+D incentives ↓ regulations ↑ trade~~

all growth

I would ↑ education ↑R+D incentives ↓ taxes for B, ↓ interest rates. Again you can lead a horse to water but you can't force him to drink

lower savings tax rates

54

- might cause inflation

12. This could be true. Computers change everything. Not only do they ↑ productivity, but they make it easier to communicate globally which ↑ globalization. I don't know if it would be enough to call it a new econ however.

56

13. Productivity falls b/c there is less additional capital. In addition wages may ↓ which ↓ morale and makes workers work less. In addition less workers decreases economies of scale making per unit output more expensive

56

56, 2, 5

14. I think it is desirable, I think ↑ standard of living is good. Growth allows pollution to be delt with and make us more comfortable. In the end growth is better then living as cavemen!

avg. living age ↑

## ACTIVITY 51 continued

Economists disagree for the following reasons:

1. Because they use different time periods. p205 review
2. Because they make different assumptions.
3. Because they have different theories about how the economy works.
4. Because they have different values and ideas about which economic goals are most important.

Now analyze each professor's comments in Part B, using the following format:

**Name of professor:** T. X. Cut

**Major point:** Tax Cuts are good b/c give incentive to work. (Supply Side)

**Time period:** Current → Recent Past

**Assumptions:** People will work more because opportunity cost of leisure went up

**Theoretical Support:**

Tax cuts are better than ↑ investment
Lets people keep fruits of labor

Tax cuts will be balanced by budget cuts

**Values:** Tax cuts are important gov must keep small
inflation can not happen

**Name of professor:** U. R. Nuts

**Major point:** Tax cuts bad

**Time period:**

**Assumptions:** " Deficit must be paid for by borrowing → hurts in future

**Theoretical Support:**

↑ Crowding out will occur
Investment will ↓

**Values:** Wealthy need to be taxed
Poor people help good

 56,3,2

ACTIVITY 51 continued

Name of professor: E.Z. Money

Major point: Crowding out stoped by ↑$ S

Time period:

Assumptions:

Theoretical Support:

(↑$ ↓rates ↑I
Businesses will loan

Values:

Name of professor: Fred Critic

Major point: Monetarists – Fed Monetary policy is messing everything up.

Time period: History → 2 years in future

Assumptions: Fed always over does monetary policy

Theoretical Support: The Fed will put too much $ out and spending will go so high it will be inflation, etc

This seems to be what happend in the past

Values:

The fed is bad for the econ, monetarist

57,1,1

# Accounting for Growth

12/11

16 Accounting for growth

Eduard Denison made estiments 1929-1982

Imputs vs Productivity (Labor)

productivity is biggest gain $\frac{2}{3}$

growth 1000-1800 = 12%

$\frac{1}{3}$ is more quantity of labor

~11 generations to 2x

since 1929 → 122 → 268 million

labor force 40 → 136 million

falling birthrates slow but imigration makes up

* large part is women are now working ⌊ for it

2 million additoal workers per year

Tech Advances

28% of growth

new production techniques, manigeral methods +

20 new business originations

* discovery of new knolowage to ↑ output

new tech often means new capital equip.

22 Quanity of Capital

20% is for new capital

workers become more productive w/ more capital goods

out put ↑ by $\frac{1}{4}$ of each part of GDP invested

important to count capital per worker

USA - about $90,000 per worker

however US investing less % of GDP then other nations

investment is also public infarstructure

- roads, bridges, airports, water

↑ infrastructure = ↑ investment

26 Education + Training

education ↑ productivity

like a capital investment

82% of US (over 25) has high school education

only? → 22% has college

28 Some nations have better education then us

57.1.2

28 Resourse Allocation + Scale Economics

economies of scale

8% of growth

↑ market size makes things innefficent

improved resourse allocation

8%

workers move to higher priority employment

30 ↑ productivity

also ↓ discrimination helps

tarrifs + quotas keep productivity ↓

Detriments to Growth

-9%

↑ regulations on industry, enviroment, + saftey

also strikes, steeling + bad weather

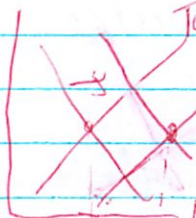
actually PL rises

economic growth ≠ better life

we might value clean air higher then production

33 ↑ must trade-off

↓



Tech Advance increase AD first as investments devlope then AS increases

Other Contributing Factors

domestic natural resourses helps

lack of doesn't doom however (Japan)

in US no taboos on growth

inventor + business man held high in society

we like work + taking risks

we reward positive actions (not like communism)

stable, democratic govt which helps companies

36 Macro Instability + Growth

recessons hurt growth alot ε carryover

not reaching $Q_F$ hurts

38 recessions ↓ investment + R+D which hurt future

58.1.1

# Productivity Notes

12/2

45 The Productivity Slowdown
in early 70's - US had big productivity growth slowdown
53 1948-1966: 3.2% - 73-81: 0.7 - 90-97: 1.2
still have higest, but USA losing edge
Significance
Standard of Living
productivity is sorse of basic growth hape
~~A~~ can only ↑ real wages if real output ↑
Inflation
56 productivity ↑ offsets inflation partally
~~A~~ ↓ productivity = ↑ resourse cost = ↑ inflation
World Markets
slow growth ↑ prices of US goods abroad
- which ↓ exports
58 Causes of Slowdown
economic growth is inverse to population growth
no reason ↗ Labor Quality
Decline in Experience level
↑ problem for Europe
↑ Muslims move in
He says Part Less Able Workers
↓ test scores
TV - 1950s
Drugs - 1960s
Rock+Roll - 1960s
↑ Sex - 1960s
Slowing of Rise in Edu attaiment
↑ in median # school years slowing
Technological process
reduces education b/c of distractions
R+D spending ↓ in 70s
60 ↓ productivity
though some say ↓ spending ≠ ↓ accomplisments
Investment
babyboomers - after WW2 the greater the % of GDP - the ↑ productivity
want normal life
no pain of Great Depression
US investing smaller amt,
Low Savings rate
- Started surberbs
- crazes for toys
low savings + high demand = ↑ rates
- school crisis
Import Competition
no pain, hard work
US producers investing less here

58, 1, 2

02 Regulation
↑ in gov regulations shifts spending to areas which don't ↑ productivity
Reduced Infastructure Spending
50s → 70s 4.1% infastructure
71 → 85 → 1.6%

04 Energy Prices
prime suspect
↑ 3 → 75 as oil prices skrocketed
↑ the cost of opperating capital
- so producers used more labor
also produced stagflation
- gov policies (tight) ↓ productivity

06 Dismal Growth of Service Productivity
slow dows were greater in service then manufacturing
harder to substitute machines for labor
less competitive pressure
- custmers more loyal
- less foreign pressure
as people grow richer - want more services

09 some say growth understated
- hard to tell output
- might not always ↓ prices

09 A "New Economy"
- since 81 have been modest growth
90 + 91 recesson halted trend, but picked up
is US resurging productivity?
- computers + global trade helping
- could we now grow at 3-4%?
many productivity depressors reversed
↑ wage premium for college over HS

12 more experienced workers

58.1.3

12 will these factors help however?
or just short term boom?
demand pull inflation next
jury still out

13 Growth Policies
what policies help growth?
Demand-side policies
low growth caused by ↓AD + ↑GDP gap
use fiscal + monetary policies to grow demand slowly
15 to keep output + investment ↑
can ↓ interest rate + pay off debt to help
Supply-side policies
goal → increase potental output over time
includes eduction + training policies
- retraing program
- college loans + credits
17 or tax polices to ↑S + I + (R+D)
might ↑ infastructure spending
deregulate industry
↓ trade barriers
19 not easy, but gov makes a difference

58 Last Word: Is Growth Always Good?
Antiglobal view
pollution + global warming
more enviroment used up
addional wants are frival
hasn't solved many homlessness proplems
can't give us "good life"
causes worker insecurities
00
→

58, 1, 4

Defense of Growth

allows ↑ living standard

gives us more time for leasure

increased care of sick + elderly

only realistic version to ↓ poverty

new machinery - less hazardous

growth ≠ pollution

02 spillover costs not =

-has even allowed pollution cleanup

58, 2, 1

THOMAS L. FRIEDMAN

# Learning To Keep Learning

I recently attended an Asia Society education seminar in Beijing, during which we heard Chinese educators talk about their "new national strategy." It's to make China an "innovation country" — with enough indigenous output to advance China "into the rank of innovation-oriented countries by 2020," as Shang Yong, China's vice minister of science and technology, put it.

I listened to this with mixed emotions. Part of me said: "Gosh, wouldn't it be nice to have a government that was so focused on innovation — instead of one that is basically anti-science." My other emotion was skepticism. Oh, you know the line: Great Britain dominated the 19th century, America dominated the 20th and now China is going to dominate the 21st. It's game over.

Sorry, but I am not ready to cede the 21st century to China yet.

No question, China has been able to command an impressive effort to end illiteracy, greatly increasing its number of high school grads and new universities. But I still believe it is very hard to produce a culture of innovation in a country that censors Google — which for me is a proxy for curtailing people's ability to imagine and try anything they want. You can command K-12 education. But you can't command innovation. Rigor and competence, without freedom, will take China only so far. China will have to find a way to loosen up, without losing control, if it wants to be a truly innovative nation.

> In the economy at hand, creativity is at a premium.

But while China can't thrive without changing a lot more, neither can we. Ask yourself this: If the Iraq war had not dominated our politics, what would our last election have been about? It would have been about this question: Why should any employer anywhere in the world pay Americans to do highly skilled work — if other people, just as well educated, are available in less developed countries for half our wages?

If we can't answer this question, in an age when more and more routine work can be digitized, automated or offshored, including white-collar work, "it is hard to see how, over time, we are going to be able to maintain our standard of living," says Marc Tucker, who heads the National Center on Education and the Economy.

There is only one right answer to that question: In a globally integrated economy, our workers will get paid a premium only if they or their firms offer a uniquely innovative product or service, which demands a skilled and creative labor force to conceive, design, market and manufacture — and a labor force that is constantly able to keep learning. We can't go on lagging other major economies in every math/science/reading test and every ranking of Internet penetration and think that we're going to field a work force able to command premium wages. Freedom, without rigor and competence, will take us only so far.

Tomorrow, Mr. Tucker's organization is coming out with a report titled "Tough Choices or Tough Times," which proposes a radical overhaul of the U.S. education system, with one goal in mind: producing more workers — from the U.P.S. driver to the software engineer — who can think creatively.

"One thing we know about creativity is that it typically occurs when people who have mastered two or more quite different fields use the framework in one to think afresh about the other," said Mr. Tucker. Thus, his report focuses on "how to make that kind of thinking integral to every level of education."

That means, he adds, revamping an education system designed in the 1900s for people to do "routine work," and refocusing it on producing people who can imagine things that have never been available before, who can create ingenious marketing and sales campaigns, write books, build furniture, make movies and design software "that will capture people's imaginations and become indispensable for millions."

That can't be done without higher levels of reading, writing, speaking, math, science, literature and the arts. We have no choice, argues Mr. Tucker, because we have entered an era in which "comfort with ideas and abstractions is the passport to a good job, in which creativity and innovation are the key to the good life" and in which the constant ability to learn how to learn will be the only security you have.

Economics is not like war. It can be win-win. We, China, India and Europe can all flourish. But the ones who flourish most will be those who develop the best broad-based education system, to have the most people doing and designing the most things we can't even imagine today. China still has to make some very big changes to get there — but so do we. □

5 8, 3, 1



## ACTIVITY 46 continued

**Part C. Analyzing the Reasons for Economic Growth**

Economic growth can be illustrated by a rightward move of the long-run aggregate supply curve or a shift outward of the production possibilities curve. Illustrate the effect of each of the following situations using AD and AS graphs. Remember that the policy may also affect short-run AS and AD. Then circle the appropriate symbols (↑ for increase, ↓ for decrease, and — for unchanged) to show the effects of the change on the price level and real GDP. Finally, explain why the policy increased or decreased economic growth.

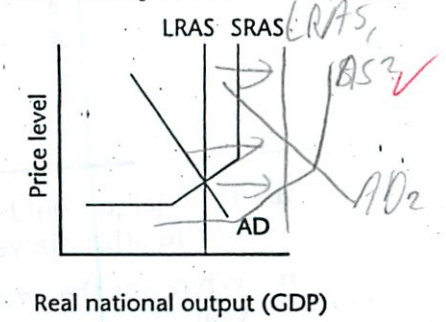
1. Because of improved education, the work force becomes more productive.

   Price level ↑ ↓ —

   Real GDP ↑ ↓ —

   Why? Better edu ↑ worker productivity

**Effect of Improved Education**




2. The Federal Reserve uses a tight-money policy to increase interest rates.

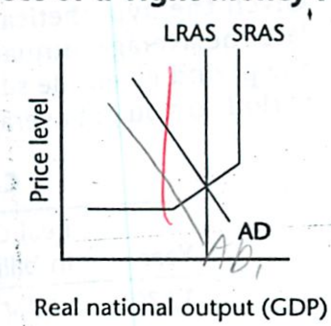
   Price level ↑ ↓ —

   Real GDP ↑ ↓ —

   Why?

   ↓AD by ↓I spending

**Effect of a Tight-Money Policy**




(1x)

3. Briefly explain how the following policies will affect economic growth and why.

   a. Higher taxes on businesses

   ↓ amt to invest in capital = ↓ growth

   b. Fewer government regulations

   more $ to spend on capital + R+D = ↑ growth

   c. Improvements in technology

   ↑ productivity = ↑ growth

   d. Lower interest rates

   ↑ investment = ↑ growth

   e. Less savings by people who want to enjoy "the good life."

   ↑ interest rates = ↓ investment = ↓ growth

   f. Higher productivity of labor due to improved management.

   ↑ = ↑ growth

 58,3,2 Michael Plasmeier

 6 98%

**Part B. Measuring Economic Growth**

1. Suppose the real GDP and the population of an economy in seven different years were those shown in the table *Calculating Per Capita Real GDP*.

**Calculating Per Capita Real GDP**

| Year | Population, in millions | Real GDP, in billions | Per capita real GDP |
|---|---|---|---|
| 1 | 30 | $9 | $300 |
| 2 | 60 | $24 | 400 |
| 3 | 90 | $45 | 500 |
| 4 | 120 | $66 | 550 |
| 5 | 150 | $90 | 600 |
| 6 | 180 | $99 | 550 |
| 7 | 210 | $105 | 500 |

a. How large would the real per capita GDP of the economy be in each of the other six years? Enter your figures in the table.

b. What was the *amount* of growth in real GDP between year 1 and year 2? 15 billion

c. What was the *rate* of growth in real GDP between year 3 and year 4? 46%

over old or new

2. Given the hypothetical data in the table *Calculating Average Rates of Growth*, calculate the average annual rates of growth in real GDP and real per capita GDP over the period given. Be sure to adjust the rate of growth for the number of years in the period so you get average annual rates.

**Calculating Average Rates of Growth**

| Year | Real GDP, in billions | Annual growth, in percent | Real GDP per capita | Annual growth, in percent |
|---|---|---|---|---|
| 1970 | $2,416 | ---- | $11,785 | ---- |
| 1975 | $2,695 | 2.3 ~~2.07%~~ | $12,593 | 1.4 ~~1.28%~~ |
| 1980 | $3,187 | 3.7 ~~3.68%~~ | $13,978 | 2.2 ~~1.98%~~ |
| 1985 | $3,618 | 2.7 ~~2.78%~~ | $15,139 | 1.66 ~~1.53%~~ |
| 1988 | $3,995 | 3.5 ~~3.14%~~ | $16,240 | 2.4 ~~2.25%~~ |
| 1991 | $4,545 | 4.6 ~~4.03%~~ | $17,110 | 1.8 ~~1.69%~~ |

over old one

59.1.1

# Deficits + Debt Notes

12/13

41 US; 5,4 million $/ debt

deficits + debt definitions
budget deficit is amt expenditures > income
public debt ∴ total deficits + surpluses over time
doesn't count state + local normally

Budget Philosophies
44 Annually Balanced Budget
-until 1930s - we wanted this
-however we discoved fiscal policy
-policy is pro-cyclical
46 -but some still want to constrict size Public Sector
-ends the constant deficit spending
Cyclically Balanced Budget
-gov balances budget over B-cycle
gov ↓ tax during reccion then ↑ to stop inflation
pay off debt
would be positive counter cyclical effect
50 problem is that swings not = in magnitude
Function Finance
having budget ballanced is secondory
primary job is to have non inflationary $Q_F$
if surpluses + growing debt needed → its ok
tax system is like this
52 -expands as econ expands
gov can finance defcits by printing $!
53 large debt not as burdsome

⟶

59, 1, 2

Public Debt: Facts + Figures

54 debt has ↑ rapidly in real + nominal terms

Causes

- Wars
  - debt grows quickly during wars
  - can't raise taxes or will diminish incentive to work
  - printing $ is inflationary
  - so they sold bonds
    - which also gave consumers less $ to buy consumer goods
- 56 Recessions
  - built in stability + fiscal policy
- Tax Cuts
  - much of cause since 1981
  - causes structural deficit
  - 58 - didn't cut spending
- Lack of Public Will
  - people want T↓ + G↑ always
  - entitlement programs hard to cut
    - 00 - social security, medicare, etc
    - spending ↑ w/ # participants
  - people + politicans want to ↓ in general
    - but hate it w/ speficis
- Quantitave Aspects
  - don't fear large #
  - 02 Debt + GDP
    - wealth of USA is big
    - can endure ↑ debt more than poor nation
    - more meaning-ful for Debt in relation to GDP
  - International Comparisons
    - 04 other nations have higher debts related to GDP
  - Interest Charges
    - primary burden is the interest charges
    - 05 4th largest expenditure on $ budget

59,1,3

social security
↓ fed to - open market operation

05 Ownership
less then 2/3 held outside Gov
gov holds rest
06 Accounting + Inflation
no assets included
gov doesn't count capital expenditures separate
inflation helps debtors
08 -largest holder of land
Economic Implications: Going Bankrupt?
false + bogus issues
Going Bankrupt?
gov not going bankrupt
refinancing
gov just keeps refinancing
doesn't pay it off
taxation
gov could ↑ taxes (Gasp!)
creating $
gov can print more
but inflationary
11 Shifting Burdens
doesn't burden children
77% of gov debt held by citizens
- also a public credit
paying off would be giant transfer payment
-redistribution of income
-no net aggregate change (forgetting the 23%)
was WW2 bad economically?
15 -had to pay for it 1 way or other

60.1.1

# Debt Implications

12/13

37 Implications + Issues
debt does pose some serious potential problems
Income Distribution
weather groups own most of the debt
payment of debt would take from poor + give to rich
Incentives
39 the intrest charges cost $ → ↑ taxes
this impears work
External Debt
US debt held by foreigners is a burden
40 higher today then before 5 → 23% (1960 → 1996)
Curb on Fiscal Policy
large debt makes it harder to turn up during recession
Crowding Out + Stock of Capital
causes future generations to inheret less capital
42 deficit financing ↑ interest rates which ↓ investment
44 First Scenario: Pay Now
↑ G = ↑ T = ↓ spending = less consumer goods
2nd Scenario: Pay Latter
↑ G = ↑ debt = ↑ interest rate = crowding out = ↓ investment
46 Public Investment
gov investments (roads, schools, etc) balances
loss of public investment
Unemployment
if econ ↓ $Q_f$ ↑ G puts resourses back to work
48 ↑ AD (through multiplyer) counteracts crowding out

→

60.1.2

49 Recent Federal Deficits
large size
size increased enormously in 80s + 90s
Understatement
recent years may be understated
gov been collecting more SS payments to save
51 some say shouldn't be counted
Rising Interest Costs
interest up 17x since 70s
debt feeds itself
Innappropriate Policy
some debts when USA at $Q_F$
53 large defits during prosperity force tight monetary
-reduces interest spending
Balance of Trade Problems
54 large defícts make it hard to balance trade
55 promotes imports + stifiles exports
bad image problems to "sell US"

Budget Deficits + Trade Deficits
58 saved for 61.1.1

60.2.1

Michael Plasmeier

Activity 47

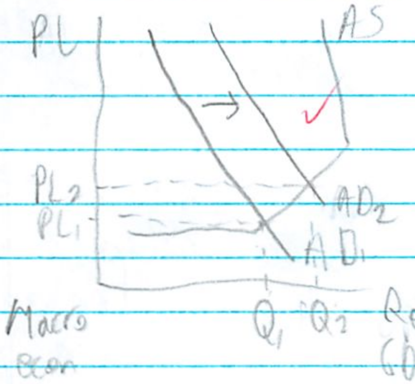
Right + Snyder

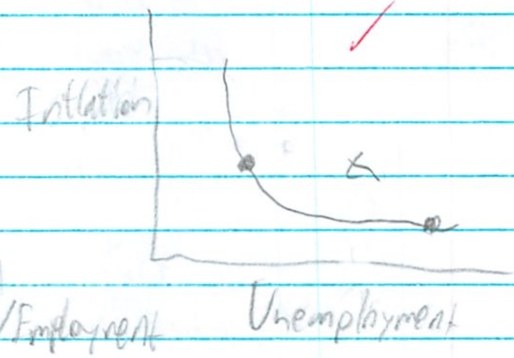
Expansion of 60s

100

Out of Order

3. Yes it was justified. An increase in AD will cause PL to rise while also ↑ employment.

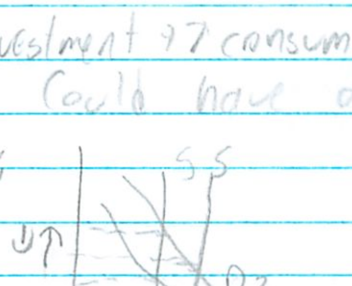


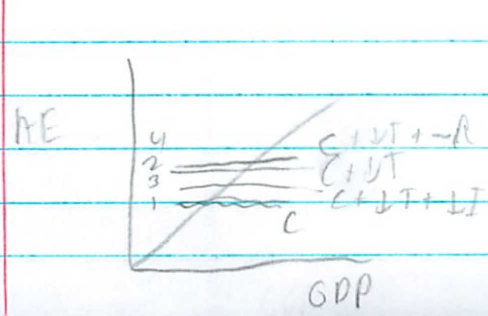

1. Potential GDP is the amount at full employment. If actual GDP does not match the amount at full employment unemployment will result. If the gap is growing unemployment is increasing as excess capacity is growing

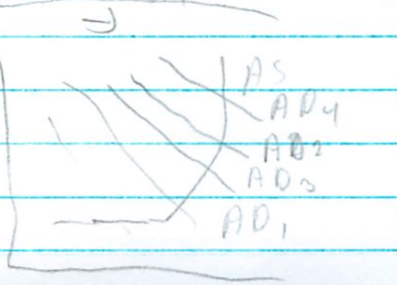
2. They weren't because they had to increase inflation assuming the economy is in the middle range. Some inflation must be tolerated.

4. The tax cuts → ↑ investment + ↑ consumption → ↑ demand for \$ = ↑ interest rates. Could have an easy monetary policy
was tight




5.




1. ↓Tax
2. ↑C + ↑I
3. ↑Rates ↓I
4. Easy \$ ↓R + ↑I

60.2.2

6 ↓ taxes on corporations = ↑ investment more $ to spend on investment instead of taxes
easy $ = ↓ rates = ↑ investment → ↓ rates = decrease the marginal cost of lending money

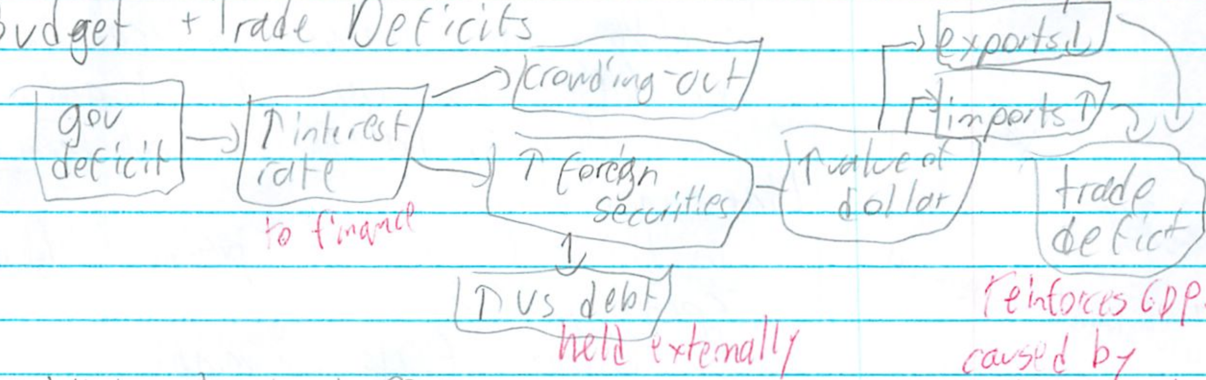
7. No if its done correctly. If the econ is at $Q_F$ the buget should be balanced. However getting there is the problem because then the budget is not balanced. Trying to balance it here would divert the economy more from $Q_F$.

61.1.1

# Policy Responses Notes

12/16

09 Budget + Trade Deficits




reinforces GDP↓
caused by
↓ Interest rates

12 Higher Interest Rates

to finance defit - must borrow \$ + crowd out private

↑ interest rates ↓ investment = ↓ growth

15 Dollar Appreciation

↑ intest rates attract foreign investment

more of debt make up is forgeign

- remember it we owe to ourselves ≠ bad

demand for \$ ↑ making exports look more expensive

and imports look cheaper

1 Trade Deficits

17 leads to unfavorable trade deficits

Related Effects

Debt not a problem if you

- ↑ productivity

- are in recession

1. ↑ foreign \$ ↓ interest rates - reducing crowding out
2. deficit caused ↑ interest rates burden developing nations w/ debt in USD - meaning they owe more
   - also, when they refinance they owe more
3. trade deficit financed by borrowing abroad or selling assets - we do both

20

21

Policy Responses

Deficit-reduction legislation

1993 Clinton-led congress ↑ tax rates

- ↑ top marginal rate 31 → 39.6%
- ↑ corp. tax rate 34 → 35%
- ↑ by 4.3 cents gas tax
- held discretionary spending stable for a year

24

61, 1, 2

in 1996 Congress passed law again to try + get
no deficit by 2002 by ↑T and ↓G
* since 1969 the balance has not been balanced
25 Line - Item Veto
in 1995 Congress gave president to veto individual
spending items
the threat of its use might scare Congress
when used - Challenged in courts
- outcome unknown when book written
27 some say gives too much power to pres
Proposed Constitutional Amendment
extream step
require Congress to balance budget each year
would do oppset of good fiscal policy
28 Positive Role of Debt
debt always plays a role in posisitive growth
as income ↑ - savings ↑ which gives $ to lend
* total US private debt = $11 trillion
31 borrowing must = savings

Investment = S personal (small) + S world (large) - S gov (neg)

Our investment comes mostly from companies abroad investing in US
more + more we can not rely on US people just investing in US

Last Word: Entitlement Program
spending on entitlements is rapidly becoming larger % of spending
interest rates on debt ↑
discretionary spending ↓
entitlements: social security, medicare/caid etc
squeezeing out discretionary spending
projected to be all of gov by 2015

Solutions:
↑ tax rates
↓ entitlements - programs + benifit levels
denying rich people access
tax the benifits recieved as income
} non political popular

36 * half of US families recive benifits from 11 largest p
social security is in trouble



# Risky Deficits?

*What effects do large Federal government deficits have on the economy? To better understand the possible consequences, consider a mythical land where the king is spending more than he collects in taxes. The story has four endings, each representing outcomes predicted by a different economic principle.*

*Count off in your group 1, 2, 3, 4. Everyone will read the story's beginning. Then read the ending corresponding to your number and decide which economic principle is represented here. Then check with your teammates to see if they agree.*

## Beginning

Once a upon a time, in the Land Faraway, King Big Debt was spending big bucks on a new castle and moat. He needed more money fast. So he hot-footed it down to the town square, stood on his favorite soapbox, and announced he was selling Government Bonds, or G-Bills.

"Why should we buy the bonds from you?" the crowd yelled. King Big Debt pledged, "I'll pay good interest! 8%, 9%...okay I'll pay you 10% and the bonds are as secure as your currency."

People lined up to buy G-Bills. They were a better deal than the Faraway Bank or the Up and Down Stockmarket. King Big Debt continued to borrow & borrow until...

## Endings

↓ Great Depression (WW2)

After reading the four possible endings on the following page, place the proper number in the corresponding box:

| | | | |
|---|---|---|---|
| 3 | **Keynesian** | 1 | **Crowding out** |
| 4 | **External debt** | 2 | **Monetizing the debt** |


continued

61,2,3

1, Most Negitive consequensi - )

2, Observe Consequenses - Yes - bush is doing this #4

3, He reposses people's houses + land + resells them, citizens mad, overthrow him + riot in the streets

61, 2, 2

## Ending # 1

One day the Private Crown Corporation decided to borrow to build a new factory. But the King had borrowed so much, there was little money left. The Private Crown Corporation and other businesses that wanted to expand found themselves bidding against one another for the small of amount of savings available for loans.

"I'll pay 10%," shouted one. "I'll pay 12%," shouted another. Interest rates skyrocketed. Private Crown Corporation cancelled its plan for a new factory. Others did the same. It wasn't long before the Faraway economy stagnated.

...THE END

## Ending # 2

The King had a bright idea. He would print up some money! He was informed that most money was no longer currency but in bank checking deposits. So, he ordered the Royal Central Bank to buy all the G-Bills and credit his account so that he could pay his bills.

With all the money earned in government projects, the town went on a buying spree. Shops were bustling and shopkeepers couldn't keep up with orders. It wasn't long before prices in Faraway went up, up, up. Coach prices soared and castles were soon out of reach of young Farawayians. Inflation had come to Faraway.

...THE END

## Ending # 3

Prior to the King's building program, the economy had languished in recession. Unemployment had been above 7% and businesses were discouraged from investing in new plant and equipment because of the poor business outlook.

After the King's program, employment picked up not only in castle and moat building, but also across the economy because businesses were more optimistic about the future and started to expand their capacity. The Faraway economy boomed.

...THE END

## Ending #4

Banks and wealthy individuals in Nearby, a land north of Faraway, heard of high interest rates and wanted to invest in G-Bills too. So, they hot-footed it down to their investment brokers and bought a high percentage of the G-bills. As a result, there were savings in Faraway available for lending to Faraway corporations, so interest rates fell back to 8%.

Years later, Nearby investors started to sell the G-bills and used the proceeds to buy things in Faraway. Soon, Faraway citizens found that their most desirable goods and services were being exported to Nearby, and that Faraway real estate and businesses were owned by foreigners.

...THE END

61, 3,1

A.P. Economics | Dr. Reilly

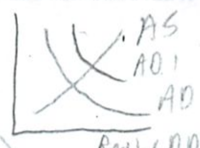
Pre-Test: Chapters 17-19 (E, 350-401)

Directions: You have 50 minutes to answer all of the following questions. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list results of your analysis. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes.

1. (50 points) The economy in at below full employment. An increase in government spending causes the government deficit to increase.

(a) Draw an AS-Ad graph showing the economy at full employment. Show on the graph and explain completely the impact of the increase in government spending on each of the following.

- (i) Price Level ↑
- (ii) Nominal Output ↑ goes up more — says real Gdp or is it
- (iii) Real Output ↑




(b) Explain how the increase in the deficit will affect each of the following in the short and long runs: Long-run AS ↔ no

- (i) nominal interest rates ↑
- (ii) real interest rates — no inflation

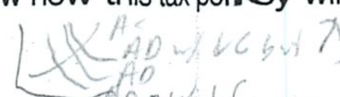
both ↔ no crowding out maybe? ↑ depends where starting — long run - talk about gov policies international markets

(c) Define each of the following

- (i) government deficit - 1 year
- (ii) national debt - year after year

(d) Do each of the following:

- (i) Identify one tax policy the government could use to promote long-run economic growth — tax cuts on ↑ - capital equipment
- (ii) Explain how this tax policy will promote long-run growth ↑ I
- (iii) Draw an appropriate graph that will show how this tax policy will affect the growth of the econonmy.




2. (25 points) Using monetary and fiscal policies, outline and expansionary policy that would encourage long-run growth.

easy $ monetary - ↓ rate to ↑ investment

? what for fiscal - expansionary ↓ T + ↑ G (investment on infastructure)

lets ↑ I spend

Continued on next page

67, 2, 2

3. (25 points) Assume an economy is in a recession.

(a) Identify one monetary policy action and one fiscal policy action that could be used to help the economy out of the recession. Explain the effect of each policy on the price level and the equilibrium level of output.

easy $ monetary = ↑rate = ↑

expansionary fiscal ↑ PL + ↑ output

= ↓T + ↑G ↑AD

(b) Given your answer in part (a) on the price level effect, explain the effect the policy actions you identified in part (a) would have on the economy's imports and its exports.

= ↑demand for $ = ↓exports + ↑imports - ~~r~~ monies opposite effect

(c) Given your answer in part (a) on the output effect, explain the effect the policy actions you identified in part (a) would have on the economy's imports and its exports.

(d) Given your answers above, explain what effect the policy actions would have on the international value of the dollar.

↑rate = ↑demand as investors flock in

long-long run - that ↑ foreign investment hurts growth of the countries we take capital from meaning they won't be as good trade partners

?

62,1,1

Economics
Reading Questions for The Choice, 1-112

DIRECTIONS: If you can answer these questions, then you have understood the book and will probably do well on the quiz and the next test on this material. The number after the question is the page on which you will find this information.

1. What was David's Ricardo's contribution to economic theory? (viii & 1)
Principles of Political Economy + Taxation -> nations benefit from free trade
2. Define protectionism. (2)
protect local producers from foreign competition
3. What is the roundabout way to produce something? (10)
produce 1 thing - trade for $ - then other country sells for $
4. What is the role of currency in foreign trade? (10)
lets transactions occur
5. Explain the theory of comparative advantage. (11)
each makes certain things best
6. Explain the point of the analogy of trade with the Olympics. (13-14, 16)
US could win if put a lot of resources to it
7. What is the point of the story of the Japanese purchase of the Algonquin Hotel in New York and the money tree? (21-22)
* americans got $ immeditily = to projected future profits
8. What is the secret of Japanese success? (23 & 24)
partnerships - gov subsidies - good edu
9. What is the point of the historic comparison between the U.S., Japan, West Germany and East Germany and the Soviet Union? (25)
* workers need incentives
10. What is the opportunity cost of growing corn? (26)
time for other things 33% 3%
11. What percentage of the American people worked in 1900? In 1995? What happened to the missing 30 %? What changed? (26-27)
↑ trade + tech advance showed children to get better jobs
12. What would happen if all diseases disappeared and American lived in perfect health to 120 years? Would the be good or bad for the economy? Why? (27-28)
good - doctors can do other things which help econ
13. Who experienced the biggest effect of the closing of an American industry, a structural change in a market? (29)
worker's children for better
14. What does economic change such as the loss of an industry mean for children's dreams? (31)
go to ↑ skilled ↑ paying jobs in other industries
15. What was Ed's experience with computers? (33)
big + slow + inefficent
16. What does Motorola, which used to make televisions, make today? (35)
cell phones + semi conducters
17. What happened to Motorola's workers when it stopped making TVs? (35)
retired, hardship, ex. other industries
18. What changes occurred in women's employment since 1960? (35)
↑ 19% - expanded econ
19. What is retailing? (36)
selling to consumers

62, 1, 2

20. How do consumers benefit from computerized control of information? (36)
better inventory + ↓ prices

21. How did the innovations at Wal-mart lead to lower prices? (37)
efficient from ↓ inventory

22. Name two innovative industries described in The Choice? (37-8)
finance + package delivery

23. What has happened to manufacturing since 1960. (38)
shrunk w/ ↑ tech + ↓ low-skill jobs

24. Why is it inaccurate to think that countries steal jobs form one another? (39)
take ↓ skilled jobs which lets retrain for ↑ skill jobs

25. Why is it inaccurate to say, "It's better to make computer chips than potato chips"? (40)
High-tech workers can ↑ skill jobs elsewhere

26. Define tariff and quota. (43)
↑ tax on imported jobs ← go to gov
+ limit quantities

27. Why does a tariff raise the price of a domestically manufactured product? (43-5)
↑ production - ↓ efficiency

28. Are the net wage and job changes created by a tariff good for America? (45)
No - they are only good for the workers affected - in general ↑ PL ↑ ↓ Living

29. Why is the harm done to consumers by a tariff greater than the gain in jobs and wages to manufacturers of the product protected by the tariff? (46)
* no cost of production ↑ - ↓ extra profit

30. Why are Americans always worse off after a tariff is passed? (47)
↑ production inefficiencies = ↑ PL = ↓ incentive to buy = ↓ joy

31. What is the impact of tariffs on the future? (48-49)
* limited choices / ↓ R+D - no future industries / jobs * - no exports

32. What is the impact of a tariff on currency and international trade? (49)
demand (for currency + goods) ↓ which ↓ value + trade

? 33. How are imports and exports inextricably tied together? (50)
? currency demand ↓ - also shuts down ↓ imports could about production - tourists

34. Why are the domestic goods produced under the protection of a tariff more expensive than those produced under free trade? (51)
no competition - ↓ efficiency

35. Why is the damage done by a tariff invisible? (51-2)
people helped isn't as apparent + don't lobby as hard

36. What American industries benefit when a consumer buys a product that is produced in a foreign country? (52) the exporters

37. Why can't the expansion of American production make up for the lost foreign imports caused by a quota? (54) P - same and ↑ inefficiency hurts econ

38. What is the difference between a tariff and a quota? (55)
tariffs give extra $ to gov

39. What is a voluntary quota? (56-7)
exports agree to do it

40. State two advantages of a voluntary quota? (57)
① faster - no one to blame

41. How much did voluntary quotas cost American consumers in 1984, individually and collectively?
(57) $ 4 billion

62, 1, 3 Isn't there still domestic competition

42. Why did a Ford Fairlane car built under tariff protection differ for a Honda Accord or a Ford Taurus built under free trade? (60)

no R+D done w/o competition - less models + improvements

43. How is tourism an export? (62)

forests give their currency in exchange for our goods

44. How is an American university education an export? (620)

again we get foreign $ - spend $

45. Define each of the following cases for protection from free trade and explain the flaw in the argument: national security (65) - what if we are at war + can't get certain

infant industry (65) - lose $ in start + don't good - we will

all businesses protect loans on mobilize + some must

46. What is the problem of retaliation if we place tariffs on imports? (69)

The other country just does the same inefficient be our allies

47. What was the story of HDTV? (73) and become locked in tariff arms race

no subsidies forced producers to compete on one

48. What is the point of the story about HDTV? (73)

competition + profit motivates too - perhaps more

49. Why should trade flows between countries be unequal? (76)

specialization means some a better in certain categories

50. Name the biggest deterrent to American selling cars in Japan? (76)

politics - wanted to say Japs unfair

51. State a possible motive of U.S. automakers for not retooling their factories to build cars specifically for the Japanese market? (77)

Cost of changing steering wheel sides

52. To what extent were Japanese trade [practices in 1992 unfair? (77)

culture favored Jap companies - even at ↑ prices

53. What is GATT? (81)

General agreements on taxes + tarrifs

54. What is NAFTA? (81)

North American Free trade Agreement

55. Which American workers were hurt by NAFTA? (82)

low-skilled, low pay

56. Why do barriers to trade exist? (84)

protect domestic production

57. How much truth is there tot the idea that free trade only works if everyone follows it? (85)

Not much - they will ↑ free trade too - Others will get rich + do it too - but there not

58. Why is self-sufficiency the road to poverty? (88)

no specialization = ↑ inefficency

59. IN the imaginary world of America without free trade did the movie "Aladdin" not get made? (89) Disney needs to export - to make enough $ to cover costs

60. How does baking your own bread illustrate the losses imposed by restricting trade? (93)

giving up more efficent activites - specialization

61. Why does Dave say that consumers should buy the car from which you get the most pleasure, regardless of where it is made? (95)

$ goes to those who make good product - and $ comes back w/ exports

62. To what does free trade lead? (98)

dynamic world, wealth, opertunity

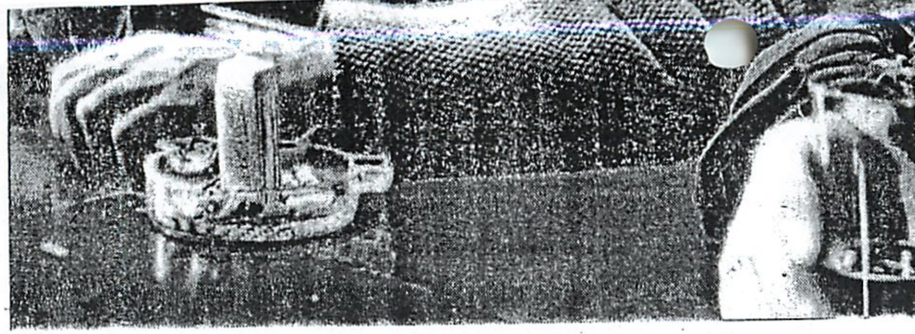
63. What is the real choice that America[and the world] faces? (99)

Static + dynamic word

62, 64

64. What do economists understand that life is about? (104)

striving, living + joining



**James Stewart** (center) is comforted by Bill Edmunds in "It's a Wonderful Life."

Phila Inq 15 Dec. '01: E1

# The 55-year-old "It's a Wonderful Life" has held up pretty well. Not because of its sunny ending. Because of its shadows.

By Dan DeLuca
INQUIRER STAFF WRITER

What's so wonderful about *It's a Wonderful Life*?

Frank Capra's 1946 morality tale starring James Stewart as a noble small-town businessman — which will screen at the Prince Music Theater Tuesday through Thursday — holds a hallowed place among feel-good holiday classics.

But beneath the surface sentimentality, all is not so warm and fuzzy in Bedford Falls, U.S.A..

Ultimately, of course, the movie masterfully delivers a Santa's sled full of uplift, arguing that every individual life is important, and that life with Donna Reed may not be so bad after all. Or, as guardian angel Clarence Oddbody writes to Stewart's George Bailey in a copy of *The Adventures of Tom Sawyer*: Remember, no man is a failure who has friends.

To bring the platitudes home with such poignance, however, Capra creates an American gothic small town, riven by class warfare, where the social fabric is so fragile that the removal of one stouthearted man can tear it to pieces.

The movie, which was shaped by the need to present a unified homefront during World War II, has largely held up well over its 55 years, despite its share of dated stereotypes, and has taken on new shades of meaning in these anxious times. If you can't catch it on the big screen, tune in to NBC at 8 p.m. Dec. 24.

Save for the Bailey family Building & Loan, Bedford Falls is ruled by Lionel Barrymore's nefarious Mr. Potter, a tycoon "sick in his mind and sick in his soul," in George's words, an old man in a wheelchair who refers to his Italian working-class renters as "garlic eaters."

Nasty things happen in Bedford Falls. Young George gets a beat-down from Mr. Gower, the druggist, who thinks the boy has failed to make a

See **WONDERFUL** on E5

BARRY WETCHER

**Nicolas Cage** and Téa Leoni in "The Family Man" (2000), a lightweight, sort-of remake of "Wonderful Life."

12/21/01

# Darkness makes 'Wonderful Life' shine

**WONDERFUL** from E1

delivery, though he has in fact saved another child from death by accidental poisoning.

The townspeople's baser instincts imperil the Bailey family when there's a run on the Building & Loan. The panic nearly plays into the hands of the greedy Potter.

George's uncle's misplacement of $8,000 leads a fear-crazed George to envision "bankruptcy and scandal and prison," and to the brink of suicide. He's an antihero ahead of his time, a family man whose grand dreams have been thwarted. "You call this a happy family?" he asks his wife. "Why do we have to have all these kids?"

*It's a Wonderful Life,* which was nominated for five Academy Awards but won none, offers a view of every individual's crucial role in the world at large — even those such as air-raid warden George, classified 4-F on account of deafness in his left ear. If everyone doesn't play his appointed role, the entire society is put in danger.

The common convention of showing a character a glimpse of an alternate universe is also put to use in *The Family Man,* last year's *Wonderful* remake of sorts starring Nicolas Cage.

Just out on video and DVD, it's a flawed movie without *Wonderful's* heft, and with a dopey ending to boot. But when Cage's guardian, played with malicious glee by Don Cheadle, sends the capitalist off to live in a New Jersey suburb, it yields some wickedly delicious results. Chief among them: the horror on Cage's face when his Armani wardrobe is replaced by bowling shirts, and he's driving a minivan instead of a Ferrari.

In *Wonderful,* when George gets his wish to have never been born, Bedford Falls is transformed into a sinful Sodom now known as Potterville. Mr. Martini's restaurant is now Nick's, which serves "hard liquor for men who want to get drunk fast." Clarence and George are called "pixies" and tossed out. The town square is now full of strip joints, pool halls and pernicious establishments that might be fun to hang out in on a Saturday night.

George's absence is felt everywhere. His brother, Harry, drowned at age 9 because George wasn't there to save him. And all those hundreds of people on a Navy transport whom fighter pilot Harry Bailey saved? They're dead, too. Worse, his domestic-goddess spouse is now a glasses-wearing librarian, a mousy old maid.

Guilt-ridden George, naturally, wants to get out of Potterville fast, and get back to suddenly idyllic Bedford Falls. And boy, are we relieved when he does, and teary-eyed when in the end, Capra delivers the warmly emotional "Auld Lang Syne" finale. But all that sweetness and light wouldn't be earned — and we wouldn't still recognize George Bailey as a thoroughly modern, conflicted hero — if, beneath the surface, *It's a Wonderful Life* didn't beat with a dark heart.

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2'2'2

6.2.3.1



Phila. Inquirer D1

# Kick back, chill out: It could save the planet

All work and no play doesn't just make Jack a dull boy. It also may make Jack a hotter boy — and harm the planet, to boot.

Two researchers — presumably keeping their hours to a minimum — looked at how long Americans work compared with people in other nations. Then they figured in productivity in terms of gross domestic product per working hour.

Not counting vacations, Americans worked 1,817 hours (34.9 a week), topped only by Greeks and Turks. Norwegians put in the fewest hours (1,336, or 25.7 per week).

Next, researcher David Rosnick and economist Mark Weisbrot, both at the Center for Economic and Policy Research in Washington, factored in energy consumption. They found that the more hours a country's citizens work, the more energy it uses.

Their point isn't that work consumes more energy than leisure. It's that more work leads to more pay (for some, anyway).

Which leads to shopping.

And the more stuff we buy, the more energy it takes to manufacture, transport and use it. Think TVs, DVDs, SUVs ...

"Your environmental footprint is proportional very directly to your consumption," says Weisbrot.

The researchers determined that if workers in the 15 nations of "old Europe" shouldered U.S. hours, as some economists urge, they would use 18 to 41 percent more energy. That would make it impossible for the continent to reach its carbon emission reduction goals, and warm the planet slightly.

Conversely, if Americans, who historically have gotten more pay instead of more time off, ratcheted back to European levels — opting, perhaps, for siestas and *la bonne vie* — U.S. energy consumption would decrease by 14 to 26 percent.

As Weisbrot jokingly put it: "Workers of the world, relax."

— *Sandy Bauers*

62, 4, 1

84

Economics

Quiz The Choice, 1-96, v.2

Last Name: Plasmeier

Date: 1/3

DIRECTIONS: Answer the following questions

Import things not as good at

1. Explain the theory of comparative advantage. (11)

Each nation has a limited amount of resources to allocate to production, In addition some areas are better than others of producing certain things. Thus it is best for each area to produce what its best at to have the largest overall output. Trade? then traded

½

2. What would happen if all diseases disappeared and American lived in perfect health to 120 years? Doctors would be out of work, initially harming the economy

Would the be good or bad for the economy? Why? (27-28)

Some

but they would retrain. Pharmiseuticals would be hurt the most, but other industries would absorb the workers. In addition, productivity would go ↑ as sick days would be abolised. Plus, if everyone could work for many more years (retirement) gets pushed back this would vastly increase the size of the workforce.

3. Why is it inaccurate to say, "It's better to make computer chips than potato chips"? (40)

It is best to make whatever you can specialize in. If potato chips are more profitable than computer chips, then so be it. Other parts of the world may be better in making computer chips, thats ok.

increasing production capacity by almost double. This would have a vast positive long term effect on the macro economy.

4. Why are Americans always worse off after a tariff is passed? (47)

Tarrifs increase the price and decrease the supply. Additional goods made domestically will have a higher production cost because they are made more inefficently than what would otherwise be avalible. Also tariffs cause tariff spirals or arms races with each country trying to out do one another.

5. Why is the damage done by a tariff invisible? (51-2)

-1

The workers and industries helped by free trade, the export industry, can not, or at least, the politicans see how trade helps them, Because of the complicated series of implications the picture is not as clear as someone crying "I lost my job"

6. Why does Dave say that consumers should buy the car from which you get the most pleasure, regardless of where it is made? In other words, why—in a macroeconomic sense—are we better off if you buy exactly the car you want whether it is made in America or not? (95)

currency

Even when you buy a foreign car, the dollars you spend must come back to America. They are traded to tourists, US export buyers, and foreign investors who must spend those dollars in America. Thus the effect is the same as if you just bought a domestic car.

G3.1.1

# Trade Notes

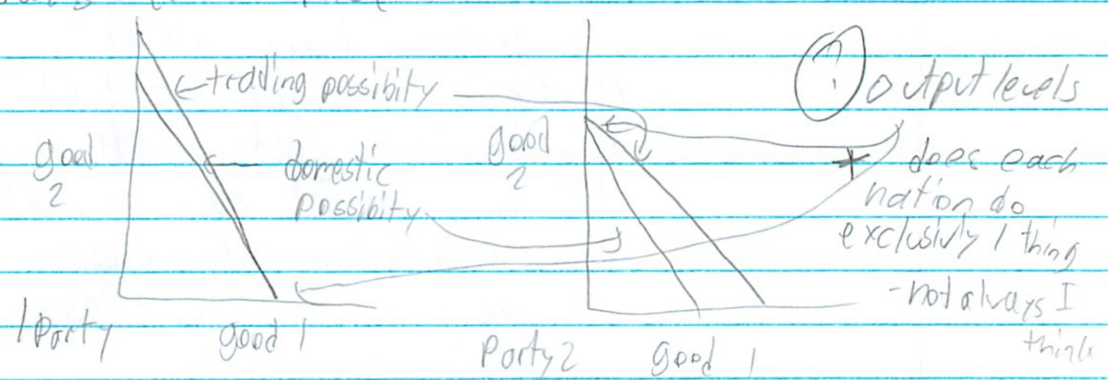
12/24

14 Facts of International Trade
Exports are 12% of US output
- a lot less than other nations
US leads world in volume of exports + imports
provides $\frac{1}{8}$ of world's exports
16 Since 1965 US exports + imports 2x as % of GDP
17 In 1996 had $191 billion trade deficit
but services surplus of $80 billion
Main Exports: computers, chemicals, aircraft
Main Imports petroleum, autos, computers
Exports same types as imports: autos, computers
19 Bulk of trade is w/ other advanced nations
↑ communication + ↓ tariffs + peace help ↑ trade
New trade heavyweights: Hong Kong, South Korea, etc
↑ trade makes econs more interdependent
Trade is usually center of foreign policy
21 Economic Basis for Trade
specialization natural resoures are unevenly distributed
efficent production requires special tech
ex: Japan has ↑ly skilled workforce good to make
cameras - labor intensive
24 Australia has lots of land for agriculture
Brazil has good climate for coffee
US has lots of capital needed to make autos
25 however distribution can chage
- if you invest in edu + capital
- or new tech
26 Comparaitive Advantage
2 Isolated Nations
Constant Costs
straight line negates Δ oppurtunity cost
Different Cost
27 each nation better at other thing

63.1.2

ratio of the

27 cost ratio: cost to exchange 1 good for another
Specializing According to Comparative Advantage
* - total output will be greatest when each good is produced by that nation which has the
30 lowest domestic opportunity cost for that good
economizing: using fixed quantities of resourses to obtain the greatest total output - requires that any particular good be produced by that nation having the lowest domestic opportunity cost or comparative advantage for each good
end up w/ much more goods produced in total when each nation specializes
33 Terms of Trade
what exchange rate will happen?
must be lower price (for each party) then producing domestically would cost
but the other nation wants it as close as possible to maximize it's take
35 demand controls equalibrium price
Gains from Trade




37

13-16 Improved Options
line moves out to represent marginal cost of the trade as set by terms of it
17 Added Output
Specialization according to comparative advantge
18 results in more efficent allocation of worlds outputs

6.3.1.3

19 and thus $\uparrow$ outputs of <u>both</u> products are <u>avalible</u> for both parties
gives a third way (besides $\uparrow$ resoures or tech) to $\uparrow$ production
20 trade with Increasing Costs
trade w/ more then 2 parties shows similar resuts
plus not always a linear PPC
23 this means that marginal cost $\uparrow$ as quantity $\uparrow$
so each party won't absolutly specialize ↳ $\downarrow$ benifits of specialization
will make some of both product
thus some domestic producers compete againts imports
24 The Case for Free Trade
Though free trade based on the principle of comparitive advantage, the world econ can achiver a more efficent allocation of resoures and a $\uparrow$ level of material well-being then w/o free trade.
26 each nation is good at something different
the world as a whole benifits from $\uparrow$ output
barriers lessen the benifits
promotes competion and $\downarrow$ monopolies
promote inovation + choice
links national interest + breaks down animosities
28 $\uparrow$ pain of going to war

63.2.1 Michael Plasmeier

# Chap 37

## Study Questions

12/31/06

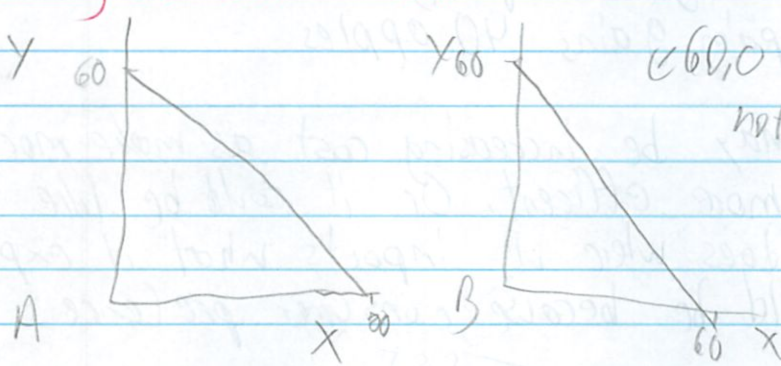
47 1. Trade is very important in the US, but not as much as other nations. Only 12 % of our output is exported vs. 56% in the Netherlands, 38% in Canada and 30% in both New Zealand and the UK. But we have the most (% of the world's output) exports in vollume.

48 2. Labor-intensive goods require a lot of skilled labor. Television and electronics are an example. Agricultural goods are very land-intenive. The right climate is needed in additon to wide expanses of arable land. Airplanes and other complicated goods are capital-intensive. Each contry must invest (specialize) in certain goods. Or it may not have enough land meaning it can't make certain goods

? wouldn't it be capital and this would be like toys

More and more this is true : clothing is labor-intensive

52 3.




c60,0 and 0,60 not 60,60 - duh!

?? ~~It seems like B is very good at making Y because it manages 60 X and still can make 60 X vs B. Wouldn't more data be needed?~~

55 between the limits of both country

Nation A is better at making X. It's better for it to make 80 X and trade 1.2 Xs for a Y

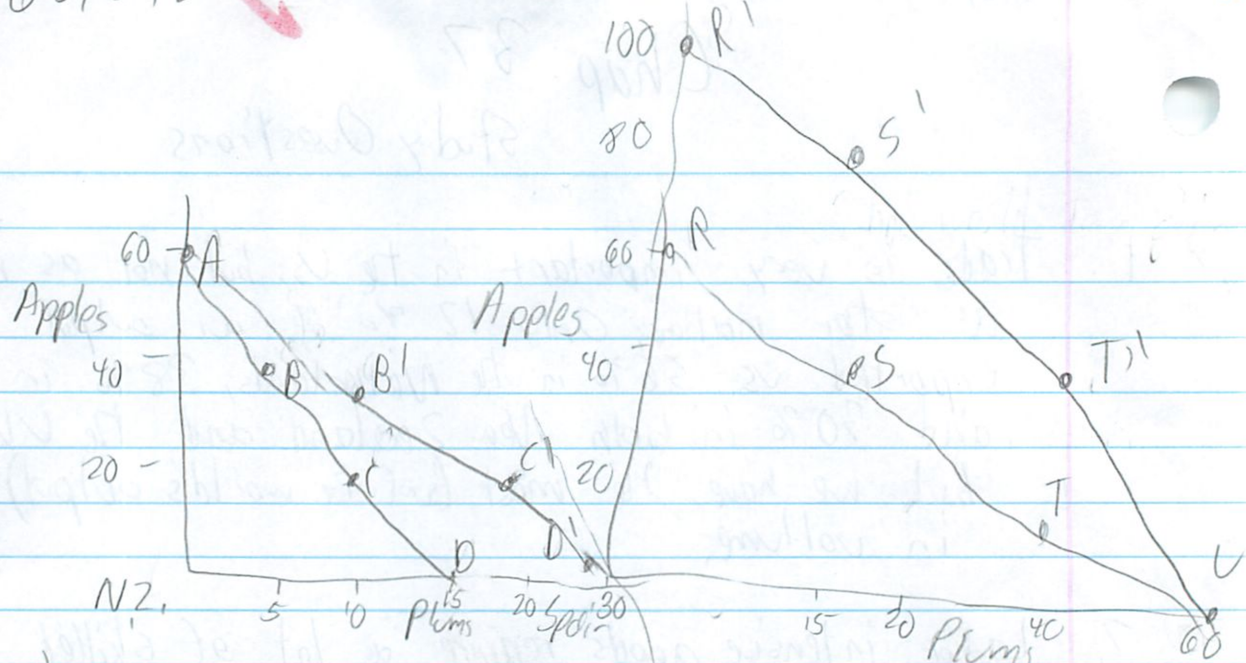
to get max stuff you have disadvantage in

?? don't really get graphing

58 see further sheets - trade max amt

63, 2, 2

28 4.




30

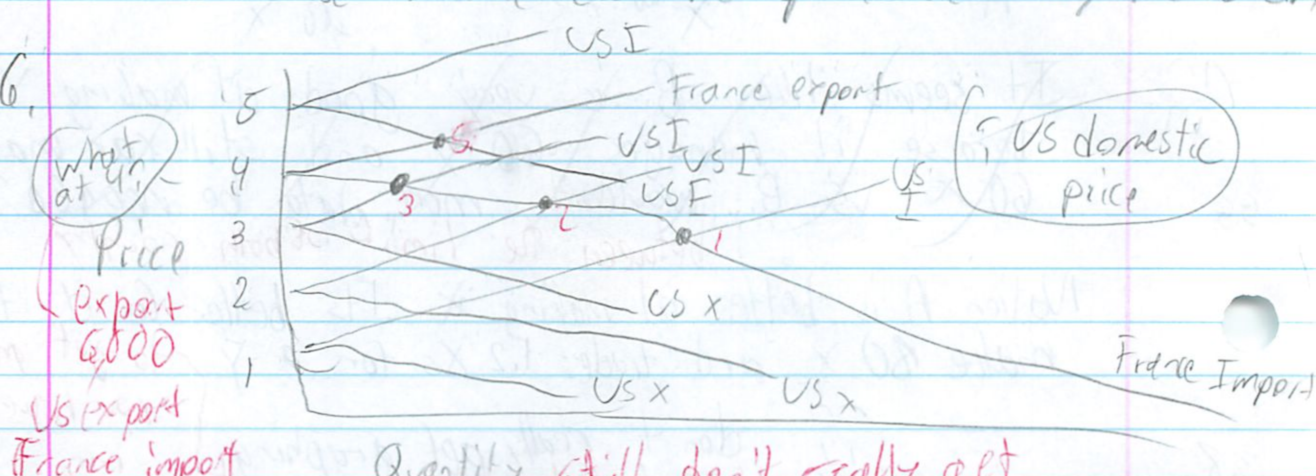
b) Spain is clearly better at making plums but the same at apples.

a) 1P = 4 Apples
1P = 1 Apple
c) 1P = 2 Apples

d) N2 gains 5 plums
Spain gains 40 apples

37 5. Their may be increasing cost as make more, making it more efficent. Or it could be like what the US does were it imports what it exports. It could be becouse consumer prefence Toyota vs GM

31/43 6.



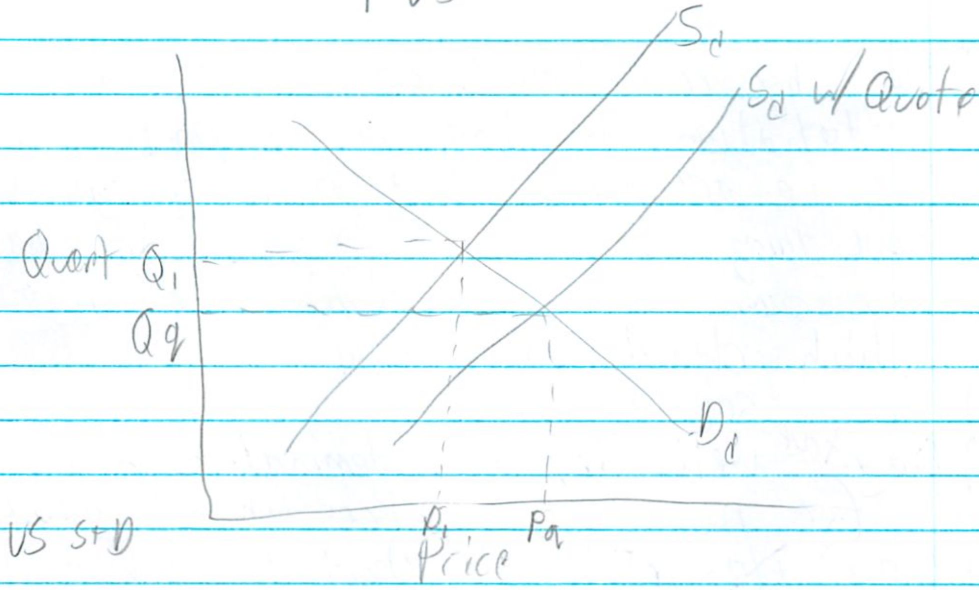

47

still don't really get

63.2.3

TVs

47 7.




a) ↑ prices + ↓ quant ☹

b) ↑ prices + ↑ quant ☺

c) ↑ Prices + — profit + ↓ quantity ☹

Quota differs b/c extra $ goes to foreigners not US gov.

36 8. The two kinda-valid arguments are the infant industry and military protection. However just what is an infant industry and what is why. Any why would you want to subidize inefficency? to help it grow? If its that far behind, it should be dead. Or able to beat the competiton on features. Also, what things are nessarry to national security? Could, if we need to, quickly ramp up production? And don't we have allies. But high-tech may not be able to be easily copied, but who except our allies exports that to us. These arguements are overused. Tarrifs + quotas hurt consumers by raising the price of production. This hurt is not off-set by extra profits or extra gov. revenue. Also the arms race would hurt exporting industries.

42

6 3.2.4

42 9. a) True, by restricting imports we are, via currency markets + retaliation, hurting our exporting industries

43 b) True, we are not the best at all things - we do some things better than others. If we had to make our own clothes we couldn't use large factories which cheaply make things

45 c) True - see a

45 d) ~~Gray~~ true well they want domination in the future - but for now they ↓ prices which is good

46 e) Gray - ~~Maybe~~ true in the short term - but trade is not a 1 way street - *both parties benifit or else I wouldn't do it

47 f) True - all competition prods R+D which ↑ efficiencies + output

48 g) So-So - I guess - Many things effect it

48 10. Short term: US prodution, prices ↑; Japan Production ↓

a) missallocated in US to auto industry - better in Japan

b) short employment: ↑, long: US auto industry ↑; US exporters ↓ - but overall ↓

c) PL ↑

d) standard of living ↓

lobbying $ inefficiencies less R+D

50 11 Costs: ↑ prices, ↓ standards of living: ↓ happiness

hurt forgivers; jobs of experts, foreign industries

Pros: ↑ jobs in directly affected industry; gov makes tarrif $

Cons > Pros

53

63, 2.5

24 12 Nafta: North American Free Trade Agreement - Canada + Mexico
GATT: General Agreement on Taxes + Tarrifs - w/ 130 nations
Both aim to ↑ international trade by ↓ trade barriers and making competing in a global world easier. The US tries to sell US goods + cuts down on restrictions againts technology moving out. Also they help fund the Export-Import bank + use threats or use or relalitory tarrifs to
27 promote exports. Lastly, they subside producers who export to try and lower their prices. US companies have trouble selling their goods in Japan b/c the Japanese have tarrifs + Japanese businesses don't like dealing w/ foreigners. I don't know what actions beyond pusing exports and ↑ their standards of living enough to get them to buy our stuff.

30 13 The sun is like a foreign competitor "dumping" his stuff on us. Protecting domestic businesses is inefficent, wasteful, and only helps a few. It annoys the rest of the consumers with its stupidity. I thought it was very good.

32

64.1.1

# Trade: Supply + Demand Analysis Notes

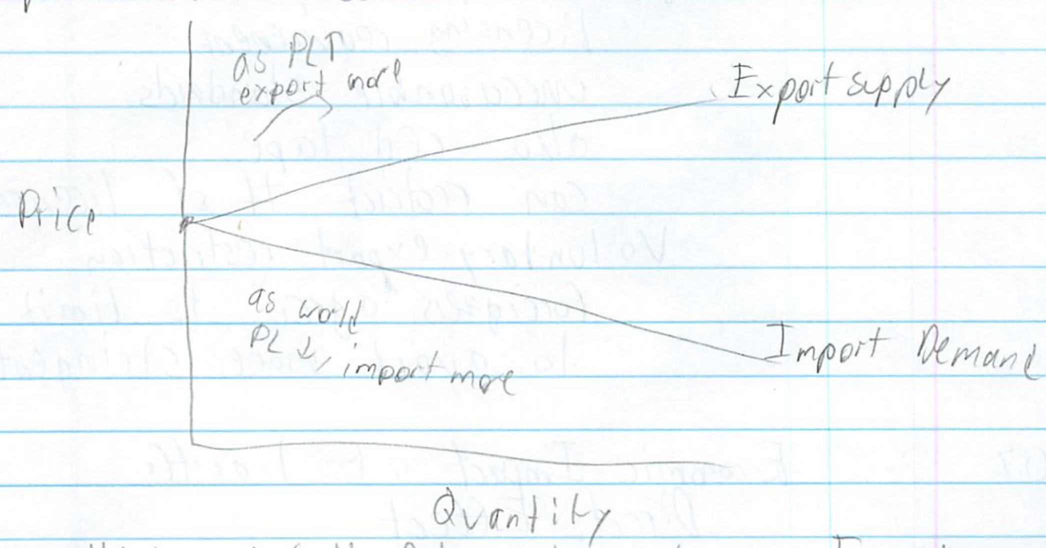
1/2

48 imports + exports Δ w/ diff. between equlibrium world + domestic prices
world price - whole world
domestic price - price w/o foreign trade
b/c specialization world price may or may not = world price

52 when world price above domestic Price
- producers make a lot (like before)
- but we only buy what we demand at that price
- so excess gets exported ↑ less then w/ lower world price
* As world price ↑ > domestic price
exports ↑

if world price below domestic price
- produces produce small amt (like supply curve shows)
55 - but we demand large amounts
- so we import

55 Import Demand Curve




57 Equalibrium World Prices, Exports, + Imports
* International equalibrium occurs when 1 nation's import demand curve intersects another nations' export supply curve.
00

64, 1, 2.

00 ✗ - Only 1 price for a standardized commodity can persist in a highy competitive market.

✗ - might make nation good at (Global) producing 1 item pay more domestically
  - they do it to finance imports

03 Trade Barriers
  Tariffs
    - exise tax
    - revenue tariff
      - on goods not produced in US
      - to provide gov w/ $
    - protective tariff
      - sheild domestic producers from imports

04 Import Quota
  limit quantity
  limit more than tariffs
  Non tariff Barrier
    licensing requirement
    unreasonble standards
    aka red tape
    can restrict # of licenses
  Voluntary export restriction
    foreigners "agree" to limit
    to avoid more stringent barriers

07 Economic Impact of Tariffs
  Direct Effect
    Decline in Consumption
      - allocate $ to less desirable substitutes
    ↑ Domestic Productivity

10 - have ↑ prices + sales
      - puts allocation of resource to inefficent use

64, 1, 3

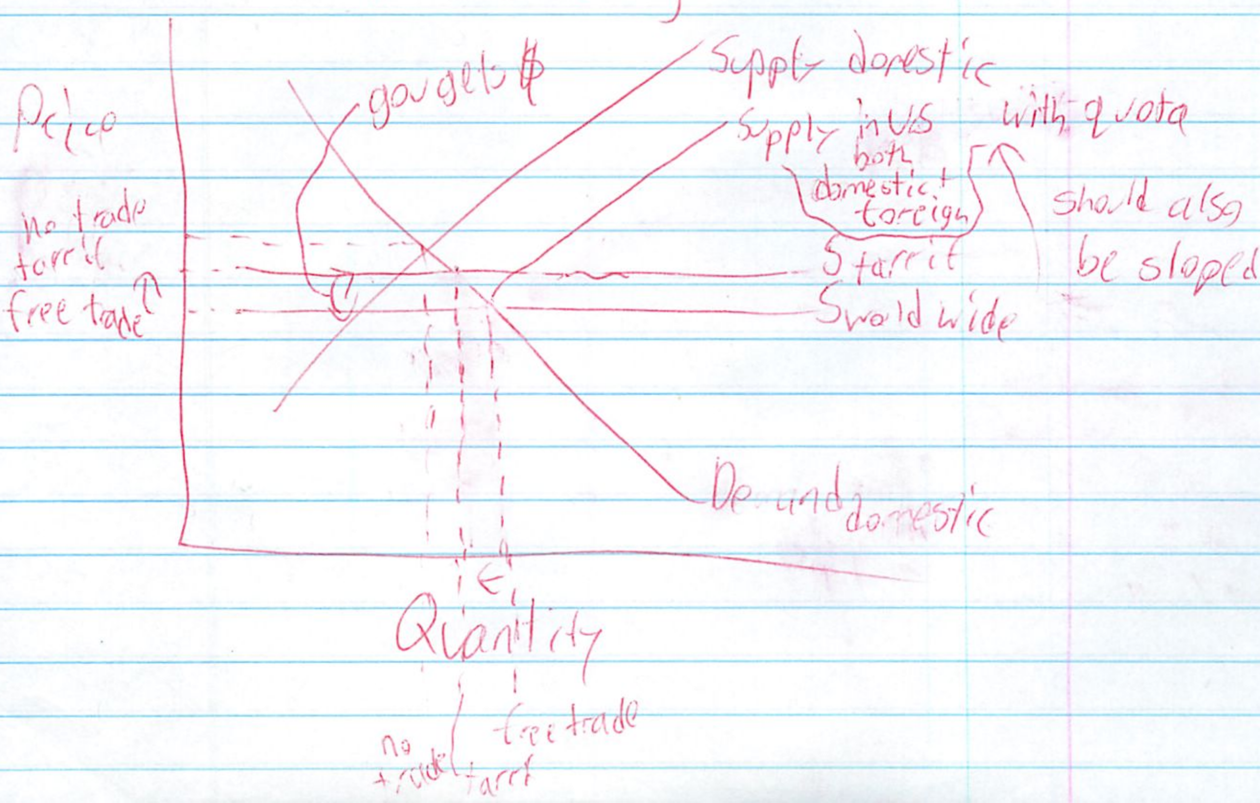
13 ↓ in Imports
- foreign producers hurt
- ↓ production + ↑ price doesn't go to them

Tariff Revenue
- gov gets $

14 Indirect Effects
- foreigners buy less imports
- industries which we have advantage in must cut production
- promote only expansion of inefficient industries
- ↓ entire worlds output

16 Impact of Quotas
- same econ effect as tariff except excess revenues go abroad instead of to gov

18 truer w/ commodities



64.2.1



# Comparitive Advantage

Activity 60

Take 2

| | Person 1 | me 2 |
|---|---|---|
| turns | * 37 | 25 |
| folds | 29 | * 48 |

~~Turning~~ For Folding

1. $\frac{37}{29} = 1.27 \frac{\text{turns}}{\text{fold}}$ ← turning

2. $\frac{25}{48} = .5208 \frac{\text{turns}}{\text{fold}}$ ← fold ← lowest is best

for output: $\frac{\text{oter}}{\text{this}}$

(5,1,1

# Trade Protectionism

1/3

44 Despite strong economic arguments, some still favor protectionism

Military Self Sufficiency Argument
- tarrifs need to strenghten industries essental for war even at extra cost
- "but every industry is "essental""
- or give subsities to the companies
- 47 The Choice: can ramp up production quickly

Increased Domestic Employment Argument
- poplar during recessions
- Job creation during imports
  - unloading ships, etc
  - salesman + other jobs from it
- Fallacy of Composition
  - 50 hurts people we import from
  - (me) they buy less of our stuff, etc
- Possibility of Retaliation
  - "trade barrier war"
  - Smoot-Hawley Act started G.D.
  - everyone loses
- Long Run Feedback
  - from imports foreigners get $ to buy our exports

53 Diversification for Stability Argument
- highly specialized markets have "many eggs in 1 basket"
- Δ may hurt contries greatly
- some truth to it
- however not relavent to US + advanced econs
- cost of diversification is large

54 Infant Industry Argument
- pitch: need to allow domestic industries to establish themselves
  - need help becoming competitive
- 56 however: hard to determin which industries are infants
  - The Choice: it's inefficent
  - protection may persist even when mature
  - 57 susbidies better than tarrifs

65,1,2

57 Strategic Trade Policy
get new tech going so it can dominate the world
then profits exceed early sacrifices
Japan + South Korea accused
however disadvantaged nation retaliate
00 Dumping
dumping is selling goods below cost
- to kill domestic competator + be a monopoly
- or price discrimination - produce excess
output to get economies of scale advantages
but keep P ↑ at home where a monopoly
many nations have laws againts it
(The Choice): small # accused by it + in weird
trials & no real evidence
Some say domestic producers take advantage
of the law to stop legitiment trade
04 * and when dumping occures, consumers benifit
in the short run the same as a domestic price [illegible]
Cheap Foreign labor argument
04 Claim: if no protection cheap imports steal jobs
however both rich + poor benifit
* trade is based on comparative advantage,
not absolute advantage
productivity is higher here, so paid more
00 * if we had to do all, we would ↓ productivity
resulting in ↓ wages
08 * A Suming Up
Some good: some cases infant industry
political-military cerminstances
But both are way overused
Protectionist ignore long run + export side

16

6.5.1.3

10 Positive Signs

1. Constution prevents inter-state taxes, were one large free trade area.
2. Great Britian in mid 1800s
3. EU after WW2
4. tarrifs ↓ world wide sine the 30s
5. Smoot Hawley → GD
13 6. Developing countries w/ protection suffer

Cost of Protection

Cost to Society

Price to Consumers goes ↑

- price of imported goods ↑
- shift to ↑er priced domestic goods
- price of domestic goods ↑

This ↑ price exceeds gov's revenue from tarrifs

05 Mid 1990s - net cost of $15 billion from protection

↑ priced raw materals ⇒ ↑ finished goods - some which are exported

lobbying cost $!

Cost of saving job > sallary loss

- just redistributes loss

18 Impact on Income Distributions

tarrifs are a highly regressive tax

19 % of income for that ↓ as income ↑

65.2.1 | Michael Plasmeier | Activity 57: Gains from International Trade | 1/4

13/14 = 4.6/5

2. Output to other this

| | Rice | Radio |
|---|---|---|
| Japan | 400/100 | $\boxed{100/400}$ |
| Indonesia | $\boxed{150/100}$ | 100/150 |

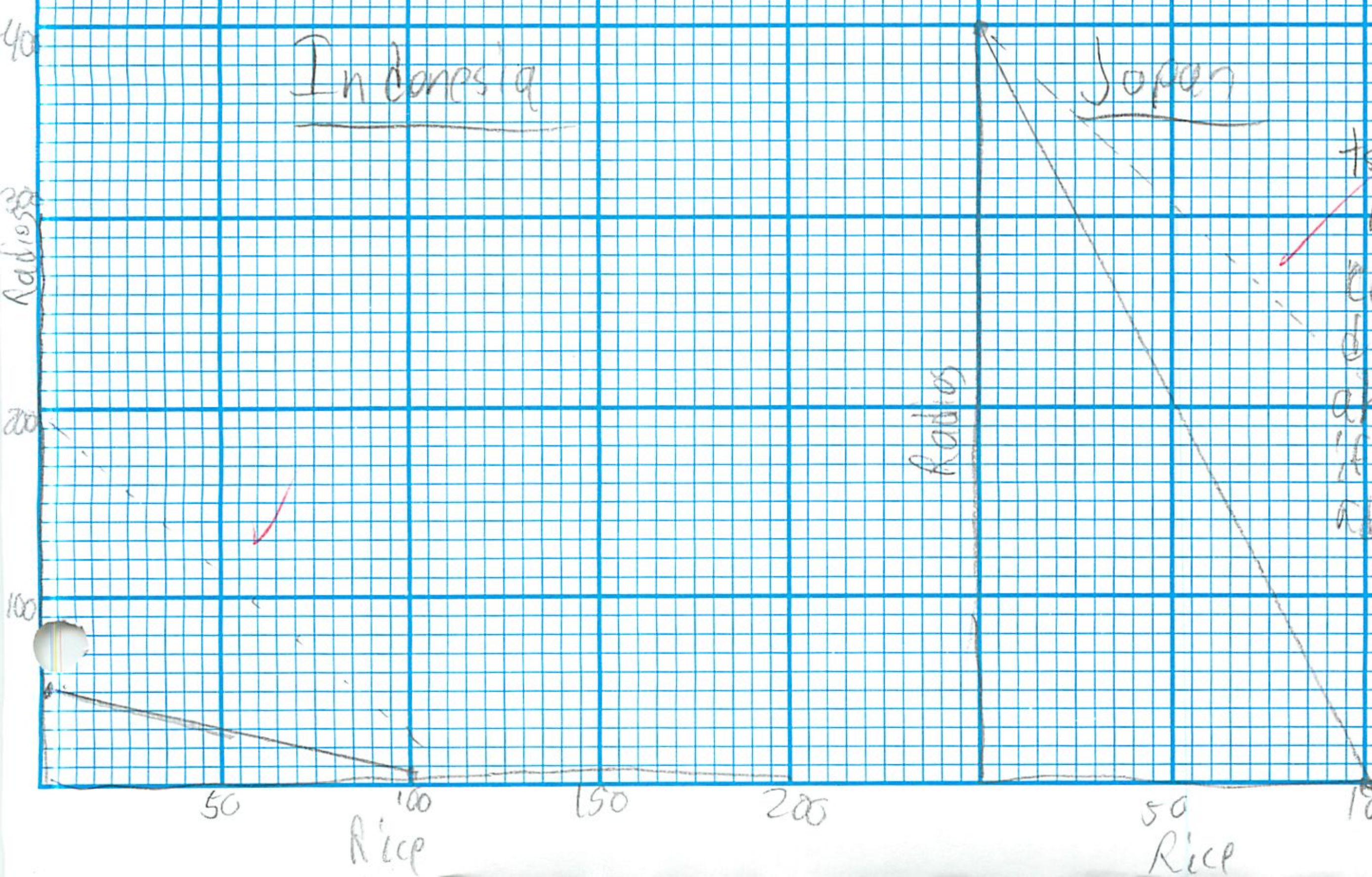
4. Absolute Radio: Japan
3. Absolute Rice: Both
6. Comparative Radio: Japan
5. Comparative Rice: Indonesia

7. ? half a pound of rice (?) simple

8. ↓ Both lines shift outwards Explain

1X

1.




to draw --- line see comparative disadvantage and calculate if give up all changes w/ trade

66.1.1

# US Trade Policies

1/4

05 in past decade → mix of generalized trade, export promotion + bilateral negoations

07 Generalized trade Liberation
- NAFTA
- GATTs
  - ↓ tarrifs
  - liberation of rules
  - 120 nations
  - ↓ agricultural subsidies
  - estimated to boost Worlds GDP 8%
  - intellectual property protection
  - WTO

09 Aggressive Export Promotion
- support high paying jobs
- slow trade deficit
- exports allow imports to be paid for
- not for all out supremicy
- leaders try to sell our goods
- ending of export controls on technology
- ↑ funding on Export-Import Bank
  - lets exports be bought on credit
- export subsidies to domestic producer
  - Clinton gave to LCD manufacters
- threats of retaliatory tarrifs to ↓ barriers

13 Bilateral Negoatiations
- discussions among 2 nations (only)
- focus usually on spefic issues
- renewal of Chinas most favored nation status
  - gets lowest tarrifs
  - but controversal due to gov + large trade defict
    - but we import so much
  - some argue trading w/ China ↑ human rights

15
  - as business grow - Communist ideology falls
  - but agreement is rocky

66.1.2

17 Negotiations w/ Japan
- large ($50 billion) deficit w/ Japan
- we want them to ↑ imports from us
  - they say market forces should rule
- we say deficit not market
  - Japanese firms like to help domestic firms (keiretsu)
- Japan says avg Japanese citizen spends more on US imports then a US person on Japanes citizens (b/c more US citizens)
- Japan has large deficit in services
- deficits still around, not going away

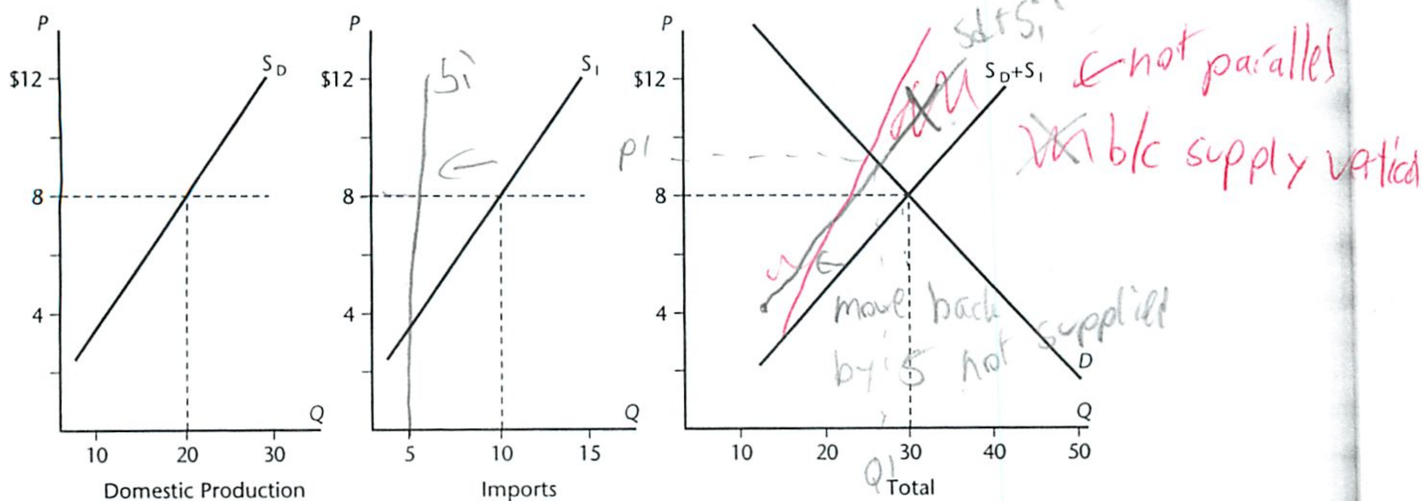
21 Last Word: Petition of Candlemakers
- what if law passed requiring curtains to be shut during day
- candle makers demand ↑ helping their workers and industries (sheep + whaling)
- of corse thats stupid
- and people will hate it + inefficent

- but sun is just like a foreign competitor "dumping" his products on us
24 - is like all "protectionism"

### Quotas

As in *Exhibit 2*, modify the "free trade" situation in *Exhibit 3* to reflect the enactment of a quota limiting imports to only five units. Indicate the effect on price, domestic production, and imports. This quota means that no more than five units can be imported into the United States during this time period.

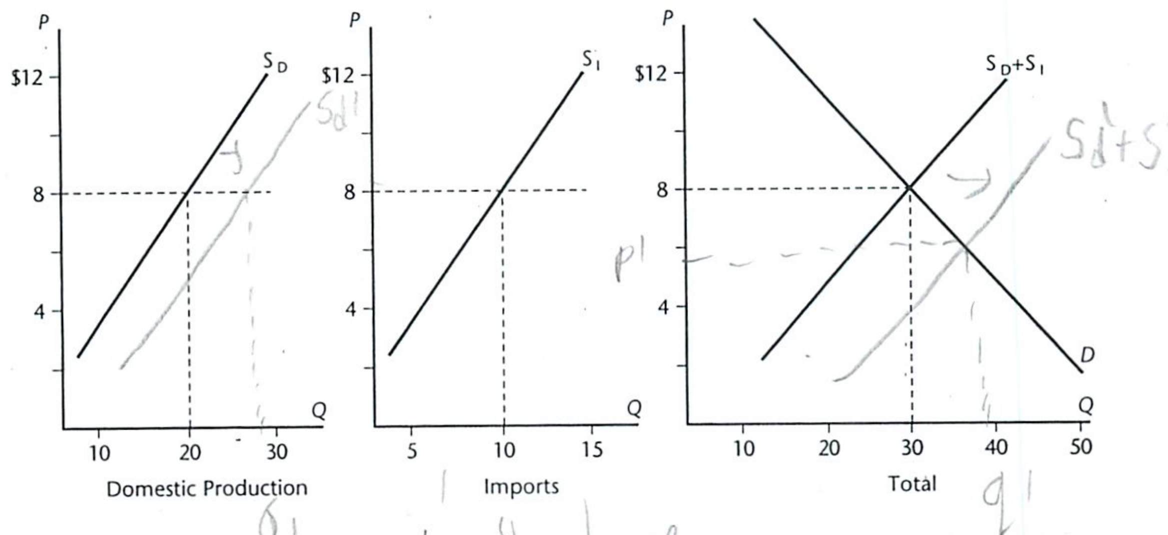
**Exhibit 3**




### Subsidies

Modify the "free trade" situation in *Exhibit 4* to reflect the enactment of a subsidy to domestic producers. Indicate the effect on price, domestic production, and imports.

**Exhibit 4**




don't change
only amt supplied

67.1.1

# Financing Trade

1/7

31 international trade involves different currencies
must exchange $ for trade to occur

33 US Export Transaction
when a foreigner wants to buy US goods, he sends his currency to the US, there a bank trades it for USD and sends the currency back to the country
35 * * US exports create a foreign demand for dollars, and the fulfillment of this demand ↑ the supply of foreign currency owned by US banks and available to US Buyers

37
53 US Import Transaction
Banks do currency transactions b/c they get fees
Reverse happens then w/ exports
* * US Imports create a domestic demand for $ US and fulfillment of this demand ↓ the supply of US currency held buy US banks and available for US consumers
* nations' exports "pay for" the imports

Balance of Payment
nation's <u>balance of payment</u> is sum of all transactions
57 b/w residents + foreign people
includes goods, services + interest
simply it includes all payments
58 CC Current Account
amount of $ traded each year
00 Trade Balance
difference b/w exports + imports
02 if imports > exports – trade deficit (unfavorable)

67,1,2

02 Balance on Goods + Services
also import + export services : insurance, consulting, travel
this includes both ↑ + goods

08 Balance on Current Account
net investment income = excess of interest + dividends
paid to US for exporting capital over what the
US pays to use foreign capital
net transfers - foreign aid, pension to those living abroad
by adding all transactions you get total balance

equal out

Capital Account
06 summarizes flow of payment from purchase/sale of real
or finance assets

Current Account =
Capital Account

"export" ownership of US goods or bonds
- represent an inpayment of foreign currency
also US people purchase assets abroad
this is "out" payment of US$

08 Official Reserves
central banks hold foreign currency
reserves drawn on to make up net deficit
like drawing on savings to make a special purchase
some years may be positive (earning $)
10 recently its mostly negative
* together debits = imports (must have a source of currency)
11
Payment Deficits + Surpluses
although balance must always be 0 there is
balance of payment deficits + surpluses which do not
include official reserve Δ
deficit not always bad
but reserves are limited - might run out
14 thus in long-run you want them to be 0

6 7, 2, 2 Michael Plasreler

38%

# Act 58

Not record

## Economic Efficiency + Gains from Trade

1.

| | Oats | Bagpipes | |
|---|---|---|---|
| US | 3 | 2 | hours |
| Scot | 4 | 5 | |

a. US has abs. advantage in oats (lowest good)
b. US has abs advantage in bagpibes

c) ~~US~~ oats $\frac{2}{3}$ $\frac{\text{other}}{\text{input}}$ $\frac{3}{2}$ pipes — hours are imports ??

Scot $\frac{5}{4}$ $\frac{\text{other}}{\text{input}}$ $\frac{4}{5}$ — yes

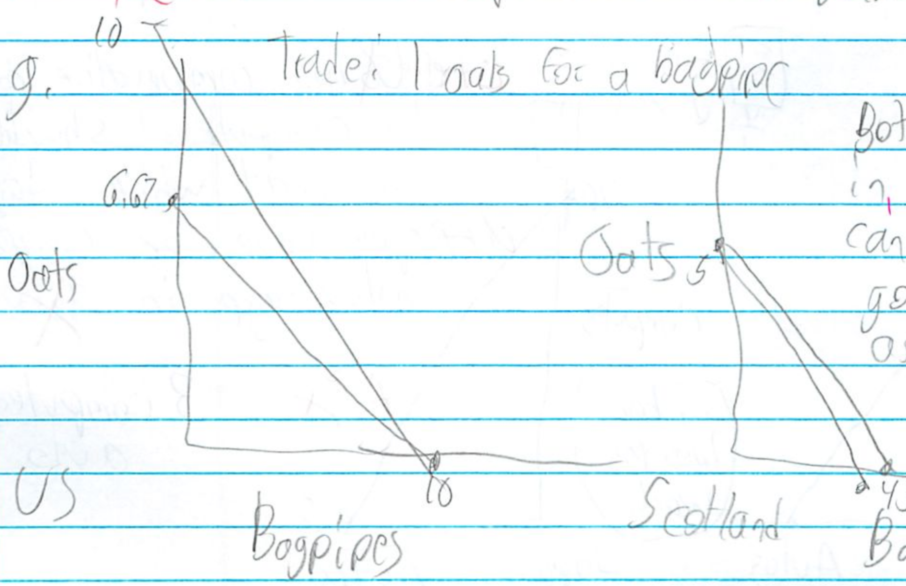
~~US~~ has a comparative advantage in oats because of the lower opportunity cost as indicated by the lower fraction

d. ~~Scotland~~ has a comparative advantage in bagpipes b/c opportunity cost is lower.

e. ~~US~~ should specialize in oats
f. ~~Scotland~~ should specialize in bagpipes

g. Trade: 1 oats for a bagpipe

20 hours




Both have an ↑ in amount they can produce of the good they are not as good at – PPC moved outward

67.2.2

2.

| | Wheat | Cloth |
|---|---|---|
| US | 1 | 2 |
| Canada | 3 | 4 |

a+b: US has absolute advantage in both wheat + cloth

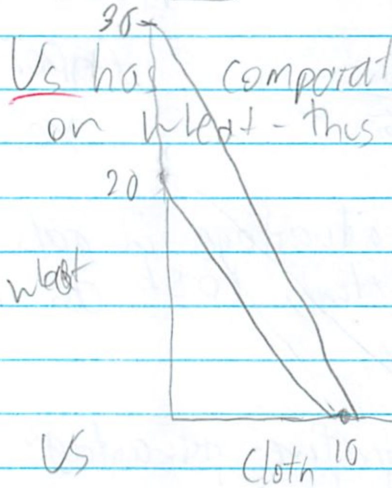
| | wheat | cloth |
|---|---|---|
| US | $\frac{2}{1}$ | $\boxed{\frac{1}{2}}$ |
| Canada | $\boxed{\frac{4}{3}}$ | $\frac{3}{4}$ |

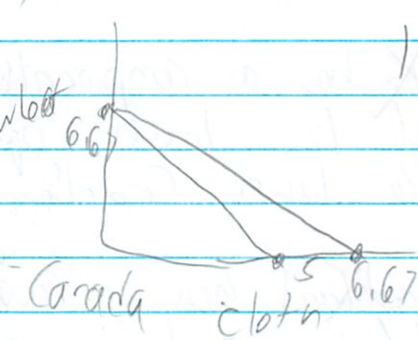
OTP: this    look who's best    ①

c ? x
d . x
e ? x
f ? x
g ? x
20 hrs

US has comparative advantage on cloth + ~~C~~anada on wheat - thus they should specialize in those thi

1 wheat per cloth




3.

| | Computers | Autos |
|---|---|---|
| US | 2 | 5 |
| Japan | 1 | 4 |

✓ ✓
a+b Japan as abs. advantage in computers + autos

| | | |
|---|---|---|
| US | $\boxed{\frac{5}{2}}$ | $\frac{2}{5}$ |
| Japan | $\frac{4}{1}$ | $\boxed{\frac{1}{4}}$ |

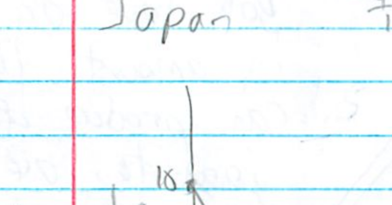
} see (i

c+e ~~US~~ has comparative advantage in computes + should specialize in that while Japan should d+f specialize on comparative advantage in ~~autos~~

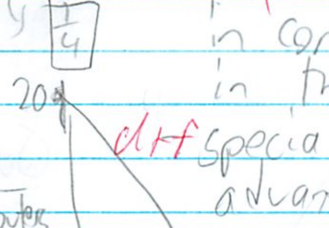
A ? x

3 computer per auto

20 hrs




??, how does this work



68.1.1

# Trade Rates Notes

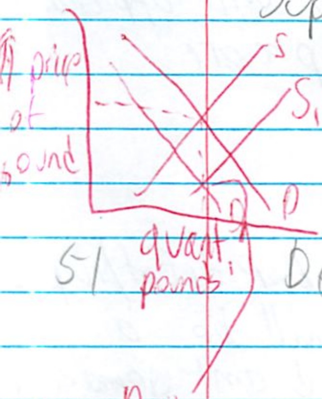
1/7

## Flexible Exchange Rates

214 / 49

1. Flexable of floating system - detemined b/c supply & demand
2. Fixed - gov changes econ to help curencies value

## Supply/Demand




Demand downsloping - more there is, the less valuble it is
- and also the cheaper goods exported become

Supply upsloping - as our price ↑, we will export less

51 Depreciation + Appreciation

when it takes more of one curency to buy another
- that curency depreciates

when a curency appreciates it takes less of that nations curency to buy another nations

Dollar appreciates S₁ or D₁

55 Determinants of Exchange Rate

- if demand ↑ it will appreciate
- if supply ↑ it will depreciate
- if 1 nations appreciates, most other nation's depreciate relative to it

56 Changes in Taste

if 1 nation's goods become ↑ demanded, its curency will appreciate

57 Relative Income Changes

if 1 nations growth is faster than anothers, its curency is likly to depreciate b/c of ↑ demand for imports

58 Relative PL changes

purchasing power parity theory - exchange rates = purchasing power of curency - that is curency's rates change w/ price level

if our goods are cheaper - demand goes ↑ $ appreciates

in pratice - rates don't follow this

however rates rely on domestic PL
- at ↑ domestic PL - we will import more from other nations - $ depreciates

01

68.1.2

16 Relative Interest Rates
if rates high in 1 country, their curency will appreciate b/c investors trying to put $ there

18 Speculation
-demand ↑
if curency speculators think a curency will appreciate and put their $ there - it will appreciate in the short term

20 Flexable Rates + The Balance of Payment
flexable rates auto adjust to remove BoP deficit/surplus
initally if demand for curency ↑, there will be a shortage, but rates go ↑, partially ↓ amt demanded b/c the P of imported goods is ↑
+ that country will ↑ its import of our goods further ↓ imbalance

24 Disadvantage of Flexable Rates
Uncertanity + Diminished Trade
risk of fluctations ↑ loss
might not invest or buy internationaly
26 Terms of Trade Δ
if our curency ↓, we must export more, to get some amt back
27 Instabality
flexable rates may ↑ demand while at $Q_F$
or appreciation of $ ↑ imports + ↓ exports which [illegible]

28 Fixed Exchange Rate
to get around disadvantege some nations "peg" rate
however S + D still changes + presurs for Δ
must actully alter demand/supply or Δ rate

30

48, 1, 3

31 Use of Reservs
can manuiplate S+D by Δ reserves
gets $ in reserves from when surplus or selling gold
but what if continued conditions depleat reserves?

33 Trade Polocies
could try to maintain rate by ↓ imports w/ protection
or subsidies exports
but ruins balance + may induce retaliation

34 Exchange Controls + Rationing
could require currency to be sold to gov + rationed
would impare importers
but is againts free trade
rationing might be Δ by favoritism
consumer choice limited to domestic goods + some imports
black market might open up

37 Domestic Macro Adjustments
use monetary + fiscal policies to ↓ spending domestically
to level of other country to balance trade

40 In sum, Fixed Rates = Bad
- methods to correct push us in recession
- so need balance + stability

68.2.1 Michael Plosnol'or (-2x) 1/9



# ACTIVITY 60
# Imbalance of Payments

Imagine yourself eating lunch at a posh Washington, DC, restaurant. Seated at the next table are Ms. Deficit, a U.S. trade negotiator, and her German counterpart, Sir Plus. Let's listen in on their conversation as they discuss the trade problems of their respective countries.

*Ms. Deficit:* This imbalance in our trade cannot continue. The deficit in our balance of payments has put many of our exporters out of business and is pushing us into a recession.

*Sir Plus:* My country agrees that the situation cannot continue. The surplus in our balance of payments is raising the price of our imported goods, and our exports are so high that we are left with fewer products at home.

*Ms. Deficit:* So we agree that something needs to be done, but what? Some of our businesses are calling for tariffs, and others want us to devalue our currency, but neither of those are acceptable policies to our government.

*Sir Plus:* Likewise, we could raise the value of our currency, but this action will surely cost the president his job.

Fortunately, the waiter arrives sparing us the rest of their conversation. While the food is being prepared, let's investigate some of the concepts the two diplomats were discussing.

Just what is a *balance of payments*? Quite simply, it is an accounting of all the payment flows going out of and entering a country, whether from individuals, businesses, or the government. The U.S. Department of Commerce records international transactions to help policymakers make intelligent decisions concerning world trade and finance.

These transactions are divided initially into two categories: those earning foreign currency (principally exports), called *credits,* and those using foreign currency (principally imports), called *debits*.

Determining whether a transaction earns or uses foreign currency is a simple way of keeping track of whether it is a credit or debit. Consider the export of an automobile from the United States to Canada. The Canadian buyer will supply the market with Canadian dollars in order to acquire the U.S. dollars needed to pay the U.S. supplier. Likewise, a Mexican tourist in the United States will supply pesos to the market in exchange for dollars. Both transactions are recorded as credit items in the balance of payments.

A U.S. tourist who plans to visit Mexico must supply U.S. dollars to the market in exchange for pesos. A U.S. film buyer who wishes to acquire film rights to German movies must supply U.S. dollars to the market in exchange for marks. Both transactions are recorded as debit items in the balance of payments.

Activity developed by Donald Wentworth, Pacific Lutheran University, Tacoma, WA.
Part of the activity adapted from William B. Walstad and Robert C. Bingham, *Study Guide to Accompany McConnell and Brue Economics,* Twelfth edition (New York: McGraw-Hill, 1993).

 68, 7, 2

## ACTIVITY 60 continued

Now it is your turn to record some international transactions. Record each of the transactions on the chart, *Balance of Payments—United States and Germany*, to show the respective balance-of-payments accounts of the United States and Germany. The first transaction has been done for you.

**Balance of Payments—**
**United States and Germany** million

| | U.S. | | Germany | |
|---|---|---|---|---|
| | Debit | Credit | Debit | Credit |
| 1. United States sells $1 million of steel to German builder. | | $1 m | $1 m | |
| 2. Bank of America pays $5 million in interest to German depositors. | $5 | | | $5 |
| 3. U.S. citizens spend $3 million on Mercedes automobiles built in Germany. | $3 | | | $3 |
| 4. A U.S. firm receives a $2 million dividend on its investments in Germany. | | $2 | $2 | |
| 5. German tourists spend $3 million in the United States, while U.S. tourists spend $5 million in Germany. | $5 | $3 | $3 | $5 |
| 6. A German firm pays $1 million to a U.S. shipping line for transporting a load of cars. | | $1 | $1 | |
| 7. U.S. exchange students spend $8 million for tuition at the university in Bonn, Germany. | $8 | | | $8 |
| 8. The German government buys a $10 million missile from the U.S. Army to shore up its defenses | | $10 | $10 | |
| TOTAL | $21 | $16 | $16 | $21 |

US - $5 million trade deficit
w/ Germany

## ACTIVITY 60 continued

The transactions in the examples in the chart are all recorded in what is known as the *current account* and are what most of us think of as exports and imports. Notice that the United States has exported less than it has imported and is left with a deficit in the current account (debits exceed credits). Germany has exactly the opposite problem.

Is this deficit a bad thing for the United States, or is Germany's surplus a bad thing for them? Here we must investigate a bit further. Ah, an international banker has arrived to join the trade negotiators. Let's hear what she has to say.

*Ms. Money:* You two are both missing half the story! If the United States is importing more than it is exporting, how is it paying for the imports? By definition, what is acquired in imports must be either paid for or owed. What you have been ignoring is the flow of capital—the so-called capital accounts.

*Ms. Deficit:* What has that got to do with this terrible deficit in our accounts?

*Sir Plus:* Or our surplus?

*Ms. Money:* Let's consider your country's situation, Sir Plus. Your country is earning far more foreign exchange (especially U.S. dollars) on its exports than it is using for its imports. What is happening to all those funds? Or your country, Ms. Deficit. How is it paying for all those imported Mercedes?

*Sir Plus:* I see what you mean. Many of our banks have reinvested those dollars back in the U.S. banks and are earning interest on them. Other companies are investing in buildings and other projects overseas as well.

*Ms. Deficit:* And I believe we are also obtaining funds from your citizens who are buying U.S. government bonds, helping to finance our government's budget deficit, and helping to keep our taxes down.

*Ms. Money:* Correct. So now you understand that a current account deficit or surplus is simply a measure of goods and services being exchanged, but it does not tell us much about the total amount of currency changing hands. You both were talking about an "imbalance" of trade as if your exchanges were like a teeter-totter with a football player on one end and a ballerina on the other—a game that would end very quickly because of dissatisfaction from both sides. I think now you understand that every exchange is beneficial to both sides, and that the perceived imbalance in your trade is really balanced by other, perhaps less visible, activities. If trade was truly imbalanced, like the teeter-totter, it would stop very quickly.

Thank goodness that discussion is cleared up. Let's look closer at the capital account.

Suppose the United States borrows funds from Germany to finance our imports. Is this borrowing a credit or debit item? To answer this question, it is easiest to think of the United States as an exporter of an IOU, and like other exports, this would be recorded as a credit. As before, this borrowing of funds would gain foreign currency for the United States, which was our definition of a credit. Likewise, if a U.S. bank lends money to a German investor to build a new skyscraper building, this would lead to a debit in our balance-of-payments capital account.

These two accounts, the current and capital accounts, record the flows of currency into and out of the United States almost completely. But like any measures, they are not completely accurate. The accounts include a place for a "statistical discrepancy" to measure unrecorded transactions, and another account to measure movements of official intergovernmental settlements (principally gold and what are known as "special drawing rights," a type of international currency).

68.24



## ACTIVITY 60 continued

The table *Current and Capital Accounts* contains hypothetical international balance of payments data for the United States. All figures are in billions. Compute the missing figures and answer the questions that follow.

**Current and Capital Accounts**

| | | |
|---|---|---|
| **Current account** | | |
| (1) U.S. merchandise exports | $+150 | |
| (2) U.S. merchandise imports | –200 | |
| (3) Balance of trade | | -50 |
| (4) U.S. exports of services | +75 -15 | |
| (5) U.S. imports of services | -60 | |
| (6) Balance on goods and services | | -35 |
| (7) Net investment income | +12 +5 | |
| (8) Net transfers | –7 | |
| (9) Balance on current account | | -30 |
| **Capital account** | | |
| (10) Capital inflows to the U.S. | +80 | |
| (11) Capital outflows from the U.S. | –55 | |
| (12) Balance on capital account | | +25 |
| (13) Current and capital account balance | | -5 |
| (14) Official reserves | | +5 ← what Δ |
| real or financle assets | | $ 0 |

2,5,8-77

must / out

"exporting" ownership

The United States had a payment (deficit/surplus) of $ $5m.

1. Does the U.S. current account have a deficit or surplus? How do you know?

A defict of $30 million, The $50 million merchandise defict is partially offset by a $15m service surplus + $5m net trans + investment

2. On balance, is the United States borrowing or lending money? How do you know?

$ borrowing $ line 10 (inflow) > line 11 (outgo)

3. Can this situation continue? (*Hint:* Think of who gains and who loses in any voluntary exchange between two parties.)

Sort of but would want $5m more $ input to stop offical resores outgo

X

yes beneficial to both parties

G9.1.1

# Rate Systems
## Notes

1/9

in school 15 3 system: fixed rate, modified fixed rate, + modified flexible

Gold Standard: Fixed Exchange rate
- mostly b/w 1879-1934
- each currency defined in terms of gold
- maintain fixed relationship b/w stock of gold + $
- allow gold to be exported + imported
- everyone would always pay same exchange rate
- 18 -when demand/supply Δ - need to make domestic Δ
  - -or else gold flow unequal
    - and $ supply will be Δ
      - this ↓ spending + thus ↓ employment
    - -or can ↓ interest rates to deter investors
  - -other country can ↑ rates
  - -their ↑ income ↑ employment + domestic spending
  - -can not respond in recession to boost exports
    - -thus making problem worse
- 23 - demise: GD
  - countries devalued currency to ↑ exports

23 Bretton Woods System
- after GD + WW2 - conference in New Hampshire
- suggested: adjustable-peg system
- sought to take advantage (fixed rate) of gold standard w/o painful macro adjustments
- Created International Monetary Fund (IMF) to manage system which lasted until 1971
- 26 How it worked
  - each nation defined currency in terms of gold
  - -to keep system stable - use offical reserves
  - -or buy/sell gold
  - 28 - or borrow needed currency from IMF using its own as collateral

69.1.2

29 Adjusting the Peg
sometimes might be big + long lasting imbalance
so could devaluate currency by up to 10%
-or larger w/ board approval
-this prevented arbitrary devaluations to boost
their exports at other's expense
32 Demise of Bretton Woods system
-dollar became international currency
b/c US bought + sold a lot of gold at fixed price
"dollar was good as gold"
1934- and b/c gold limited -↑ supply of $ grew trade
1971 but US experienced persistent payment deficit
-most financed w/ $
$35/ounce -as gold ↓ + $ ↑ - nations became worried
to maintain balance had to remove deficit but
would limit $ growth
US ended fixed exchange killing system

36 Current System: Managed Float
1971 - present
"almost" flexible
... Currency free to move w/ market - but nations can intervene
40 to remove persistant deficits/surpluses
intervene by buying/selling large amts. of other currencys
43 in 1987 G-7 stabalized $ (from trade deficit) by
buying large amounts
-↓ value of $ is bad for them
some nations peg to other currencies or baskets
45 of many currencies
Support
trade grew similar to B/W Woods system
46 flucuations not really a problem

69, 1, 3

46 currency crisis b/c of internal problems + pegging (recent)
to other nation's currency
in some cases flexable rate made adjustments
more gradual than w/o
also it weatered big problems - like oil '73-'74
inflation mid '70s, recession '80s - system adjusts

48 Concerns
rates are very volatile
volatilty hurts free trade
speculation affects rates too much
* has not remaved trade imbalances like it was
suppose to
50 critics say system not defined enough
- may not only smooth out short-term but
prop up chronically weak currencies
52 but system has survived

Recent US Trade Deficits
56 been large + persistant
Cause of trade Deficit
at home since 1992 - grew too rapidly
55 US has large gov budget deficit
- ↑ interest rates
↓ savings rate = ↓ investment
- large capital accounts surplus
57 - means ↑ consumption (including imports)

Implications of US Trade Deficits
benefits + costs both
↑ed Current Consumption
58 trade deficits means consumption ↑

69,1,4

00 but at the cost of future consumption
Red Indeptress
The extra trade must be financed by borrowing from the rest of the world, selling assets or dipping into reserves
foreignes hold a lot of claims againts our debt
02 also no incoming dividends

So we must fix imbalance or be under permant debt, permente foreign ownership, or large sacrifices of future consumption

03 Last Word: Foreign Curency Speculation
Contribute to flucations
magnify large curency devaluations
but don't cause b/c must be structural problem
07 Smooth out short term fluctations
when price goes ↑, tay sell ↓ price
absorbing risk
bear risk oters do not want when people hedge in futures market
04 "exchange-rate insurance"

69,2,1

EVALUATING A USED CAR

(NOTE: Exotic cars are more expensive to maintain and repair than common models.)

**RESEACH BEFORE YOU SHOP:** Go to Edmunds.com and explore under "Used Cars" and "Discussion Groups." The more you know about a model in which you are interested, the better a deal you can negotiate.

**Step 1. At First Glance:** (Do not shop for used cars on a rainy day; the rain will hide a bad paint job and discourage you from doing what you need to do.)

_______Beware of newly painted cars—could be a cover-up of problems

_______Has it been parked outside? That is hard on the paint job.

_______Are there many dents or mismatched areas of paint or poorly fitting body parts? If so, this car could have been in an accident.

_______Look in the glove compartment for signs of water damage—could have been in a flood. If so, do not buy it!

_______Look inside for wear on seats, headliner, and pedals. Could mean future repair bills.

**Step 2. Look at the Tires and Underneath the Car:**

_______Are tires and spare unevenly worn? Could be a problem with the suspension. At minimum, you will need to buy tires.

_______Look underneath for any drips. Where are they coming from? What color, feel, and smell does the fluid have? (clear is water probably from air conditioner or the windshield washer; oil means a leak—a problem; green and sweet smelling is coolant—a problem; red is transmission fluid—forget it! Transmissions cost $1 to $2k to fix.)

_______Look underneath for rust: rust on the body will only get worse (a new pain job will cover it but won't fix it); rust on the frame--forget it.

_______Inside of the wheels for signs of leaking brake fluid—a problem to fix.

_______Stand up; bounce the car at a corner (stand on the bumper and jump off). If it bounce more than twice the shocks will probably need replacing.

_______Look at the exhaust pipes and the muffler? Do you see holes or metal flakes? If so you may need to repair or replace it soon. Lower your offer by at least $200.

69.2.2

**Step. 3 Check Under the Hood:**

______Look for mismatched bolts—it means that a part has been replaced. Not necessarily bad.

______Look at underside of the hood for signs of sprayed fluids. What is leaking?

______Look for an oily and possibly dirty film—there is an oil leak somewhere.

______Look at the belts and hoses for cracks and fraying—a minor problem but will need replacing or they will cause a breakdown on the road.

**Step. 4 Listening Test:**

______Sit in driver's seat with car in park. Turn key the on—does it start right up? If not, why not? If it needs a tune up, have the old owner do it and call you back then.

______Have a friend watch the tail pipe for smoke as you start the car and it warms up. White smoke that quickly dissipates is normal—water vapor in exhaust system. Blue smoke is the worst—burning oil, meaning there is a bad oil leak. If so, forget this car.

______With the hood open and the motor running do you hear clicking sounds? Could be a valve problem or a bearing--neither is good!

**Step. 5 Check Oil and Brake Fluids:**

______With engine warm, shut it off and let it sit for a few minutes for the fluids to settle.

______While you wait, check the break fluid reservoir—is it above the "MIN" line? If not, DO NOT take for a test drive—it may be unsafe.

______Now you are going to check the oil;

______a. Pull the dipstick and wipe it off on a rag or a paper towel.

______b. Before reinserting, study the markings on the dipstick to be sure that you understand how to read it.

______c. Reinsert it and read the level; if is low , assume that the car has not been well maintained.

______d. Dirty oil is not a useful indicator of any thing other than the possible need of an oil change; frothy oil may mean a leak somewhere; metal fragments in oil--walk away now! This is a sign of major engine failure.

**Step 6. Check All Lights to see if Ready for Safe Operation:**

______Test all lights, signals, and the horn to be sure that they work. (This is again where you need a friend to help you.)

69.2.3

## Step 7. Controls and Displays

______Return to the drivers seat and check the following before starting the engine:

______Play in the steering wheel--it should move no more than about 2 inches without hitting resistance.

______Play in the clutch--if it goes too far before engaging, the clutch needs to be adjusted if not replaced.

______Play in the brake pedal--if it is squishy rather than firm and there is plenty of brake fluid in the reservoir (Step 5 above), the master cylinder may need replacing, a repair costing 100s of dollars.

______Fasten your seat belt.

______As you start the engine, look at the instrument display to be sure that warning lights blink on and then go off--you are trying to get an idea if all the indicators work.

______If there are gauges, verify that they are all operating in the safe range.

## Step 8. Pre-Test Drive Tests:

______Test everything—radio, tape, CD, AC, the heater (when the engine is warm), all windows, the wipers, the window washers, the trunk (is it wet? This would be caused by a leak somewhere—hard to find.), the spare (is it inflated and usable?), are all the things there needed for changing a tire?

______Turn off the radio and air conditioner once you know that they work—test the car with the windows open and then closed so you can hear the sounds of the car.

______Set the emergency brake and put the car in gear. Does the emergency brake restrain the car? If not it may need adjusting or the car may need the brake pads replaced. (cost: 100s of dollars)

______Release the emergency brake and let the car roll at idle speed--do not touch the accelerator--then test the brakes. Do they stop the car satisfactorily? If not, DO NOT DRIVE IT! It is UNSAFE!

69,2,4

**Step 9. The Test Drive:**

______As you drive, as soon as it is safe test the brakes again at about 15 mph:

______Do they pull to one side? If so, they need to be adjusted--not necessarily a major problem, but it should be taken care of or the price should be reduced.

______Do they screech? The brake shoes are worn and need replacing. This is moderately expensive but is a normal repair.

______Do the brakes fade (stopping range varies)? Could mean the brake shoes are worn and need repair.

______Do they shudder? This suggests and uneven brake rotor, a costly repair.

______Repeat these tests at 30 mph and 50 mph.

**Step 10. Further Testing the Suspension:**

______Does the steering wheel shake as you make a turn? This indicates a suspension problem, a more expensive repair.

______Does the steering wheel vibrate as you accelerate to expressway speed? If so, there could be an alignment problem, a less expensive repair.

**Step 11. Testing the Transmission:**

______Does the car have a manual transmission? Clutches eventually do go bad and are expensive to replace.

______Is it tough to shift--stick or feel stiff?

______Does it slip out of gear especially right after shifting? Clutch problem.

______Is there a grinding sound? That means clutch or transmission problems. If it grinds just in one gear, it is most likely in the transmission.

______Does the car have an automatic transmission?

______Does it jerk as it moves from gear to gear?

______Does it seem to remain in one gear too long?

______Does it fail to accelerate as you rev the engine? (Watch the tachometer.)

Any of these could mean the need for adjustment or repair—both risky and possibly expensive. Get an estimate for repair before buying.

69.2.5

**Step 12. Testing the Engine Compression:**

As you drive on the open highway, find a moderate hill to climb.

______Does the car climb the hill easily or does it require a lot of acceleration? (Watch the tachometer.)

______As you go down hill, remove your foot from the accelerator to see if the car slows on its own? If not, carefully down shift and try again? If the answer is no in either case, this could mean the need for repair of the rings, a major expense. A mechanic could easily give you a more definite answer.

______As you go down a hill with the windows down—and the transmission in neutral, If safe to do so—listen to the sound of the car. Any squeaking not related to whether you press the accelerator or not, is in the wheels. Squeaking may mean a bearing in a wheel need to be replaced. After stopping, feel the hub--if it is too hot to touch, that is another sign of a bad bearing.

**Step 13. Testing the Differential:**

______After you stop, put the car in reverse, accelerate and stop several times. Did you hear a clunking sound? That would be the differential—an expensive repair.

**ONCE YOU OWN THE CAR--**You may want to visit http://www.jonko.com/--for car repair tips.

**POWER LIBRARY TIP**

**EBSCO Publishing - Auto Repair Reference Center - THE 2004 INFORMATION WILL BE ADDED INTO THE DATABASE AT THE BEGINNING OF 2005. Supplied by Point 5 Technologies with complete automotive repair information supplied by Nichols Publishing, publisher of Chilton© information. Most major manufacturers of domestic and imported vehicles are listed. Repair information is available for most manufacturers as far back as 1954.**

**GOOD LUCK! Buying a used car is always a risk but should be cheaper than buying a new one.**

69.3.1

# ✓ Chap 38

Michael Plasmeier

Study Questions

1/11

20 1. When a car dealer wants to pay for Japanese cars, they send dollars to Toyota. Toyota then goes to a bank where there are people willing to pay yen for dollars (the Japanese importers), they then trade currencies at the market rate and Toyota gets the yen they need for production. The same, except in reverse happens when Italians try to buy US machinery. Thus there needs to be a balance in trade, ① or else
25 a currency's value will change

38 2. a. creates demand (exported from france, return for $)
b supply (need $)
c demand
d supply
e ~~demand~~ - we want exports supply - we put their currency out of our reserves
f demand ($ → francs)
g supply

41 3. a balance of trade: + 10 } cumulative
b balance goods + services: + 15
check c " current account + 20
d capital accounts: - 30
deficit - we are investing too much abroad + drawing on our official reserves.
e $10 balance of payments

44 4. Yes - the two are linked. If one appreciates, it's price will ↑ related to all currencies and one gets more of a particular currency then before
47 No purchasing power parity (which says direct link b/w currency value + how much it can buy. Relative price is only a factor, among speculation, taste,
49 and relative interest rates

69.3.2

50 5. Sabb has to pay for german parts in kronas. When the German mark appreciated, they had to exchange more kronas per mark, hurting them. In addition they recieved less kronas per dollar for their exported cars when the dollar depreciated. This represents a double whammy for them.

52 6. The demand curve for currency is downsloping because as the price ↓, we get more of that currency b/c it allows us to buy more of it. The supply curve is upsloping because as the price of that curency rises, they will purchase more of our exports, supplying more of their curency into our market.

56 ?? a ?? both or ↑ demand for their exports, so appreciation

?? ~~b.~~ appreciate - ~~they want cheaper~~ imports ?? depreciation

59 c depreciation ↓ demand demand less imports - demand ↓

?? d depreciation - Mexico can't import as much from us

e depreciation - capital moves here

f appreciation ↑ demand

?? g appreciation = ? ↑ demand

h ~~??~~ appreciation = ↓ Prices here b/c their prices ↑

03 7. a True. A countries imports varry with its income. This causes ↑ supply in world's markets.

b. True. There is a ↑ demand b/c of ↑ investment demand

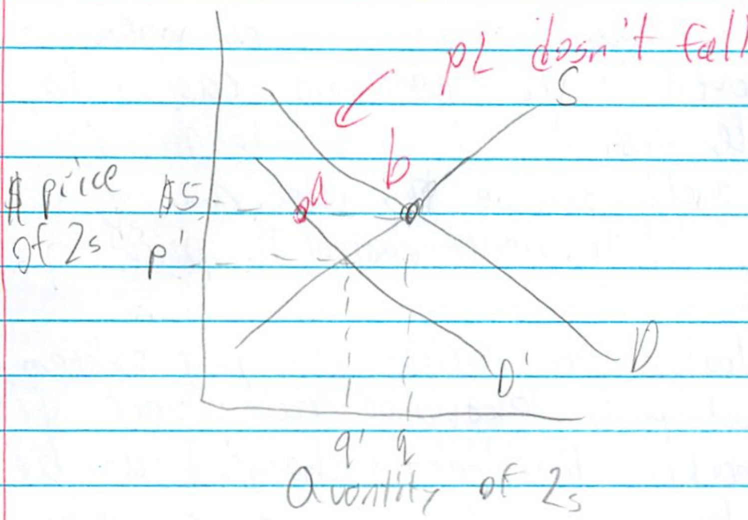
05 c. True. The lower prices will attract foreigners which ↑ \$ demand

56 8. This is not taking into account net investment income and net transfers. (although they are negitive - we send more out) But mostly its missing all of the investing foreigners do into us, but also its missing the \$ we send abroad to purchase assets. Lastly it doesn't

04 count any changes in the offical reserves.

69.33

10 | 10.




12 | a If the exchange rate was fixed and there was a decline in the demand for Z's (taste, speculation relative price, income, rates) a few things could be done to prevent a surplus of Zs. First the extra Zs could be purchased and put into reserves for a later deficit. We could offer dollars or gold for Z's. If we run low on reserves, they could ↑ demand by subidizing exports, we could also limit our exports to them to help ↓ supply of Z's but this is a bad choice. Or we could try and ↓ spending w/ fiscal + monetary policy but this usually is a bad idea. or we could leave it for later ones to suffer through.

15
can't ↓ supply b/c P would end up lower
1/2

18

20. | b With flexable rates, the price just goes down. This makes their exports look better, therefore ↑ it partially. shortage means it appreciates

2/2
21

30 11. The Bretton Woods System aimed to keep the stabality of the gold system but without the painful domestic macro changes. The Woods system set up the IMF to facilite the changing values of currencies by adding and selling other currencies when nessesary.

69.3.4

Exchange rates could — be changed if the board approved it for perminant cases. The system 42 disolved when the US could no longer pay $35 per oz of gold because they were running out of gold. Instead they let the market control the price

what else to do. →

44 12 The managed float system followed the peg system. For the most part, exchange rates are determined by the market. Perminant changes can be delt with by buying and selling currency. Also Also some currencies are pegged to others.

48 13. The US trade deficit has grown b/c people aren't buying our exports as we buy their imports. Also the deficit ↑ rates, attracting foreign investors. And we are saving less, having foreigners buy our assets, and letting us ↑ consumption of imports.
56 This is good now, but we are trading more assets to foreigners, which will hurt us later. If we ever want to regain ownership, we would have to pay more (surplus).

Thus these are unfavorable.

52 14. The rate may go up and down. A speculator must look at the causes of changes to guess if it will go up + down. If their currency appreciates, they make extra $. But if it depreciats, they will pay extra. Thus they "hedge" their bets by agreeing to buy the currency from a speculator at a certain rate.

56

70,1,1

# Economics of Developing Nations

1/10

10 more then 20% of world's population lives on $1 a day

11 The Rich + The Poor
income inequality b/w nations too
83% of income goes to 20% of people
poorest 60% gets <6% income
13 26 industrially advanced nations (IAC)
- market econs w/ lots of capital
rest are developing countries (DVCs)
- 107 nations
- agriculture focus + ↓ productivity
3/4 world's population
in 1995 - all DVC's GDP < US GDP
16 US: 5% population → 25% output
30 GM's GDP > all but 22 nation's

34 Growth, Decline, and Income Gaps
growth in certain DVC is faster then in others
some have decined (Sub-Saharan Africa)
and some are now IACs
* DVCs must grow faster then IACs to narrow gap
35 Implications
very poor people w/ not enough to eat, little shelter, + work hard

37 Obsticles to Economic Development
paths are same as in developed nations
must use resourses more efficently
↓ unemployment + ↑ capital
must ↑ supply of resourses
38 Natural Resourses
resourses vary country to country
39 some held by multinational companies

70.1.2

may be vereable to volital prices
tropic climates = ↑ disease + ↓ productivity
41 but some nations (Japan) do well w/o resouses
Human Rights
overpouplated
43 ∴ have large pouplation to support + large growthrate
growth: 1.6% DVCs, .7 IAC
44 * 9 out of 10 people are born into DVCs in next few years
$\text{Standard of living} = \frac{\text{food production}}{\text{pouplation}}$
46 if production would ↑ w/ pouplation its not a problem
- but may just ↓ deaths + ↑ births making the problem worse
Savings + Investment - large families reduce capacity to save - ↓ I
Productivity - capital must ↑ w/ pouplation or
48 productivity ↓
Resourse Over use - may plant too much
Urban Problems - city growth brings slums, pollution + crime
Birth control is a sollution
- but hard to distribute things / information
- agricultural areas need workers
- children care for parents in old age
51 - nations w/ most to gain reject it
China: 1980: 1 child / family
- but paplation grows
51 Qualifiations
Japan + Hong Kong are very pouplated + well-off
pouplation growth ↓ from 60s'
demographic transition view says income must ↑ first, then ↓ poup. growth follows
53 in IACs marginal cost > marginal benifit of kids

20.1.3

64 Under + Unemployment
lots of people not working enough hrs, doing other things
and not using time productivly
as high as 15-20% in DVCs
large migrations to city ↓ migrant job oppturnites
56 in many DVCs labor >>> capital so hiring
a lot of people works
57 Low Labor Productivity
don't invest in capital machines
workers are unequiped
+ as poup ↑, per capita capital ↓
also don't invest in human capital
- not much education
- and medical care
59 ?? → - in some countries hard work is accoated w/ slavery
entrepenurs don't want to bare risks
no supervisors
the universities don't teach much math + science
authotarian goverments don't want trade
OC the best workers go to IACs "brain drain"
Capital Accumulation
- all DVCs don't have as much capital
- better equiped labor forces ↑ productivity
- nation must prodce more output to get ↑ goods
- studies show in DVEs relation between
investment + growth
03 - more capital ↑ agricultural production
- capital accumlation may feed on itself
Direct Capital Formation
nation must save (like others)
but savings impediments are larger | 2-5% income Africa
but some DVCs save alot | US 15%
05 India (22%) and China (42%)

70, 1, 4

10 Capital Flight
investment $ goes to IACs
aviod te risk at home from gov's instabity
- Δ taxation - seizure
- hyper inflation - volital exchange rates

12 Investment Obstacles
lack of investors + incentives to invest
high risk
weak domestic demand except for argiculture
+ hard to compete w/ mature industries in IACs
little infastricture
- poor roads, little + infreq. water + electricty
DVCs must invest in infastructure by employing people
instead of just spending $
- but it requires leadership + cooperative spirits

16 Technological Advance
tech. knowledge might be shared (crop rotation)
little ↑ "productivity" may go a long way
↑ not really productivity
investing some $ in better tech helps
also some tech ↓ $ like better fertilizer
better off DVCs have used our vast knowledge

19 tech not always can move over b/c requires
skilled labor or capital
much of our tech is based on ↓ workers
also DVCs econs might not Δ quickly
- if it fails there's big trouble

21

Sociocultural + Institutional Ideas
growth also Δ ways people interact w/ one another
must have "will to develop"

22 must not be satified w/ old way of doing things

70,1,5

22 Sociocultural Obstacles

tribal + ethnic itenty stronger then nationalism

rival clans battle one anoter

- sub-saharan Africa

24 caste system restricts labor growth

religons divert resourses to devotion

capricious universe view - feel that their outcome are not dependent on what they do

reincarnation ↓ importants of personal life

25 Instutional Obsticals

gov corruption + bribory hurt things

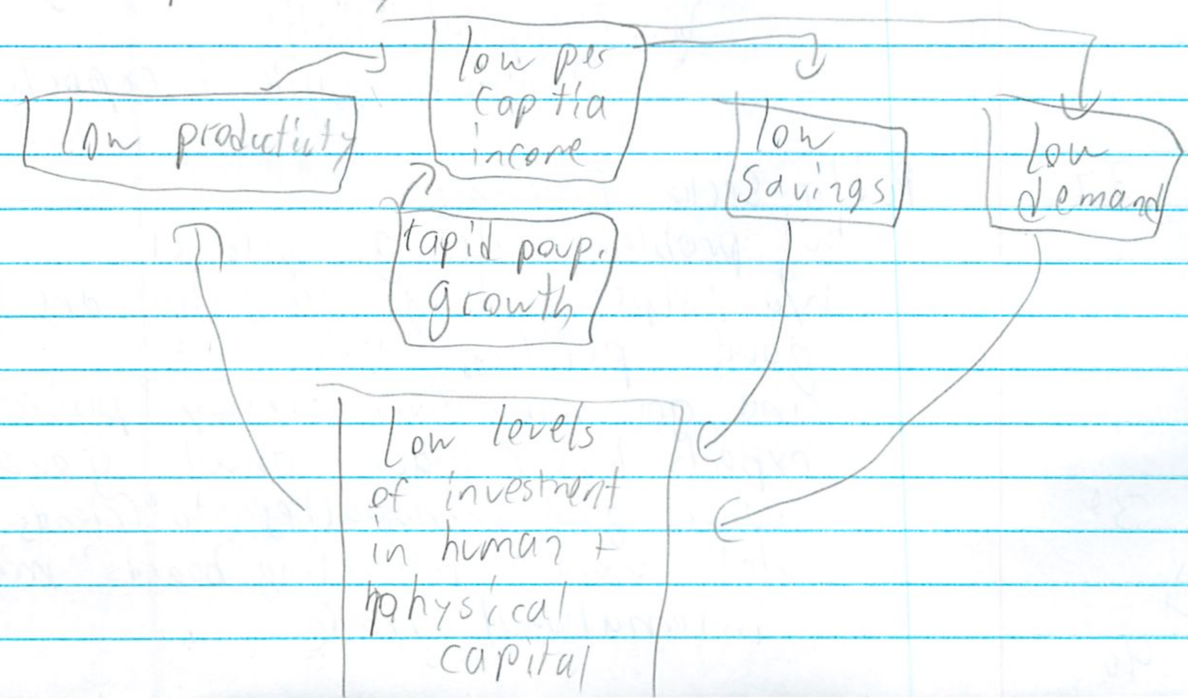
govs + schools run inefficently

desire to ↑ prestiege not production

26 land reform - need balance b/w wealthy few ordering around poor "servents" with little motivation or small farms w/o benifits of economies of scale

28 The Vicious Cycle

the poor stay poor




30

70.1.6

30 to break out - need to $\uparrow$ investment
but $\uparrow$ poplation overides capital growth
if poplation stays $\downarrow$ - per capita income $\uparrow$
this reverses cycle into regeneration, benifical cycle

33 Role of Government
economist don't agree what role should be
A positive Role
law + order
gov should make + inforce laws to keep peace
lack of entrepreneurs
gov should try + motivate private investment
34 infrastructure
gov should $\uparrow$ it
forced savings + investment
govs may force people to $\uparrow$ capital
by $\uparrow$ taxes (if system stable)
smart → idea inflation - people need to invest or lose value
except { - but it distorts savings to luxory items/goods
- $\downarrow$ volentory public savings
$\uparrow$ capital flight
$\uparrow$ imports while $\downarrow$ exports

37 Public Sector problems
but problems when gov plans
w/o entpenurs in private sector - are there any
good politicans
and gov may face "showy" projects
experts less entuastic about gov's role
38 leaders give monopolies to friends
state owned "marketing boards" monopolize
international trade

Ten!
40

70.1.7

40 A Mixed Bag
Some positive: Japan, S. Korea, Taiwan
But: Zaire, Nicaragu + Haiti all did poorly
soviet union's fall shows central planing doesn't work
many DVCs see that capitalism works best

42

70.2.1 Michael Pflaumer

Chap 39

Study Questions 1/14

46 1. Developing nations have low levels of industilization, Literacy rates are low, unemployment is high, popu. growth is rapid and agriculture is main industry. They can grow by getting + investing in capital or by building infrastructure + education. But its hard to invest when you don't make much. Thus you can't invest much, thus you don't have much capital and you end up in a vicious circle of recurring poverty. Decrease consumtion and increase investment to solve

51.

2. Inflation is a major problem in DVCs. Income growth can not match the inflation and population growth.

or growth rate?

52 3. 3% · 500 = $15 Gap $75
3% · 5000 = $90

55 p 4. a Partially, They should follow our model of investment + entprenuraliship. But not nessarily take our cultre

check

67 b. I don't think income inequality causes savings. The tyrant leaders of some DVCs are the richest in the world. I don't think that would help much. We must use other methods

58 c Not really. Humans will adapt automatticaly. No change must be forced upon them. If they could invest they would. However infrastructure must also be there. True some attitudes toward

06 growth must be changed

70,2,2

00 d. I believe that we are trying to help them grow. If we didn't they would cry look at that rich nation not helping us at all. How selfish. We are trying to improve their lives. When we loan them money we do need to impose controls or it would all be wasted and not have much of a difference

02 c. True - they need capital to improve productivity and then ↓ population

02 5. Rivers + seas provide essental shipping rauts. Without these, shipping becomes much more expensive. I don't see how G-P 38-1 helps...

??
graph

05 6. The demographic transition view holds that econ. development must proceed population growth ↓. It argues that children are made in DVCs to provide extra labor on farms, support for retired parents. The traditional view says that

21 7. It is just too risky to invest in poor DVCs. In IACs you are almost assured of getting it back while the climate in DVCs is not the same.

??
risk

28 8. The government needs to first create stability w/ laws + dearmament + build up infrasture before private entpresises look seriously at investing

36

70.2.3

54 9. The debt crisis of the 1980s was caused by a combo of the following reasons. An ↑ price of oil, tight $ policy caused a ↓ in US imports and ↑ interest rates when refinancing. The problems were solved by forgiving or extending the debt.

56
55 10. During the 1990's private capital flow returned to DVCs. But the makeup was now individuals and businesses directly investing instead of banks and goverments mearly lending money to their governments. These trends, I believe, occur because private businesses realize that there is money to be made. Plus the goverments no longer want to get political support.

58 11. DVCs export unprocessed agricutural products the most. These require large amounts of unskilled labor and little capital equipment. Other countries, good at manufactuing, are better off (via competitive advantage) producing more processed goods.
2/2

00 12. Immagration is a tough issue. We should do what we need to do, but not forget that these people need work. The brain drain also is a problem - the goverment should have incentives to make it harder for those people to leave
2/2

03 13. South Korea and Chile experience rapid economic growth because of outside influences. Their stable goverments attract private capital which brings jobs to these areas + ↑ productivity
2/2
05

70.2.4

05 This breaks the vicious cycle.

05 14. The famine in Africa is caused by many factors.
Civil strife prevents investments and siphons
off aid to the people. It makes war not
growth the priority of the often corrupt
governments. The population growth exceeds the
food growth, ultimately decreasing food per capita
08 The environmental degradation blows away
the soil, tires it out and burning dung
instead of using it for fertilizer is
inefficient. The government also tries to lower
crop prices to feed the urban population
04 but it removes the incentive for the farmers.

7.1.1.1

# Role of IACs

1/12

Role of IACs

inschool

Expanding trade

34 simplist thing is to ↓ trade barriers

but problem sometimes is missing capital + foreign assis

but dependence on IAC demand leaves vunerable to recessions

-especially in mineral

36 Foreign Aid; Public Loans + Grants

Supplement savings + investment system

breaks circle of poverty

builds infrastructure

Direct Aids

past 10 years $10-14 billion a year USA

$60 billion/year worldwide

distributed on political basis

only give 1/3 → 1% of our GDP

World Bank Group

-lends capital funds

sells bonds

39 -guarantees private loans

"last resort" lending agency

lends for infrastructure, building up for private invst.

technical assistant

41 Foreign Harm?

Dependency + Incentives

countries become dependent not self-sufficent

42 in 50 years, demand for aid grew

00 Bureaucracy + Centralized Government

aid given not to citizens but gov

normally generates large bureaucracies

moves resources from private sectors

02 Corruption and Misuse

10-20% aid diverted to gov officals

03 some of the wealthist people in world are rulers of [illegible]

71,1,2

03 about 1/4 spent on "consultants" in IACs
IACs companies distribute aid
04 Decline of Foreign Aid
$58 → $40 billion 1990 → 1996
US + USSR not vying for allegience
05 Private Capital flows
IAC's companies are starting to invest
banks make loans
"emerging markets" fund
06 DVC's Debt Crisis of 1980s
couldn't pay back loans
causes ↑ price of oil tilted balance of payments
07 tight $ policy in US caused ↓ imports + ↑
interest rates ↑ borrowing cost
appreciating dollar meant DVCs had to
08 export more to pay back debts in dollars
corruption caused bad investments which didn't
pay back
09 ended much of the private investment
IACs wrote off + extended a lot of debt
10 Reform + Revival in the 1990s
private capital ↑ briskly
DVCs agreed to reform econs + promote growth
11 tried to ↓ budget deficit + control inflation
↓ tarrifs + Δ unrealistic exchange rates
however makeup diff; more private investors
not commercial banks
12 more direct foreign investment, not to banks
building factories ↑
not viewed as "foreign exploitation"
13 flow toward China, Mexico, Southeast Asia, eastern Europe
not Africa
14 but crisis not totally resolved

71, 1, 3

14 still heavy debt burdens
no assurance against future defaults
problem alleviated not solved
some currencies nosedived
16 IMF had to rescue
10

Where from here?
DVC policies
make + inforce laws
open economies to trade
- grow as much as 1.2% more
Control population growth
- frees up women + savings
11 - increases per capita living standards
encourage direct foreign investment
build human capital
- education (+ keep locally)
13 make peace with nations
establish independent central banks
- to control inflation
establish realistic exchange rate policies
reduce shocks caused by balance + speculation problems
privatise state industries
14 IAC polocies
direct aid to poorest DVCs
-not current political + military influenced
15 ↓ tarrifs + import quotas
- especially on processed things
DVC debt belief
Allow temp workers + discourage "brain drain"
discourage direct arms sales
17 - divert resourses from infrastructure

71.1.4

17 Last Word: Famine in Africa
20 1/4 children <5 died of famine
drought caused it directly
but Africa can't feed itself
Civil Strife
armies divert $ + aid from population to them
corrupt leaders sell aid + keep $
discourages investment
22 Population Growth
pop. growth > food growth
so per capita food ↓
Ecological Degradation
lands deforested for wood + farmland
soil blows away + goes bad
animal dung burned instead of fertilizer
land overused
no good crop storage
24 Public Policies
favor industrial + military development
↓ price of crops to feed urban pop.
aid may undermine self sufficiency
growing debt
25 cutting back on social programs

72.1.1

# Ideology + Institutions Notes

1/15

05 China + Russia have 20% GA + 24% of people

Ideology + Institutions
- Marxist ideology
- Central planning
- Russia - 1917 - Lenin + Stalin
- China - 1947 - Mao

08 * communial ownership of capital + land
- supposly represents the working class (proletariat)
- capitalism: chaotic, unstable, inequtiple
  - inflation, unemployment, discrimination, bad distr. income
- central control: rational, provides stabilty, equality
- labor theory of value - value of good determined by its value

11
- free the proletariat from exploitation of borgisie
- capitalist keep surplus value
- state keeps surplus value
- classless society w/o exploitation

12/14

State Ownership + Central Planning
- state ownership
  - gov owned all land, transport, natural resources, communication + banking system, industry farms, stores, houses

15 Central Economic Planning
- command economies
- choices made by bureicrats as if nation was 1 big company

16 Planning Goals + Techniques
- Industrilization
  - large heavy industry growth
  - China: agricultural goods
  - generally ignored consumer goods,

17 service sector + distribution

72.1.2

17 Resourse Overcommitment
not every target could be met
emphsis on heavy industry, rural development, military
18 Resoursc Mobalization
initally achived growth by mobalizing existing labor + capital
forced people to work
* grew by adding imputs, not by ↑ predictivity
20 Allocation by Directives
not market system
Gov Price Setting
not supply + demand
prices seldom Δ esp. on nessecities (ex. housing)
only accounting measures
21 Self-Sufficiency
Single socialist nation surrounded by hostile capitalists
strong military (China vs. Russia)
23 vied for influence in developing nations
traded only (mostly) among other commusit nations
Passive Macro Policies
money played a limited role - about quantity
monetary + fiscal policy were passive
↓ unemployment b/c of wasted workers
* no cost-minimization objective
25 little inflation b/c gov said prices can't go ↑
- but common shortages
26

Problems w/ Central Planning
Coordination
hard to set realistic targets + find resourses
bottleneck → outputs of some industries are other's imports
harder to plan as nation grows
27 in begining were all about fight WW2

72,1,3

28 not worried about consumer goods
but econ became more complicated + system broke down
* no single sucess indicator (capitalism: profit)
They had quantitave targets - and quality failed
Can't set a goal people won't find way around
The Incentive Problem
30 profit is incentive to do well + invest
The gov can misjudge
then shortages + surpluses
no easy way to Δ production
no entpreneurship incentive
Why improve? - Why work hard?
32 * route to get ahead was in politics
innovation was resisted
also isolated from import competition
34 extra money didn't do much good

72.2.1 Michael Plasencia
Using Fx Rates
Activity 61

28/34 = 82% = 4.1/5

1/16

| | May | June |
|---|---|---|
| 1. | $416.66 | $420.168 |
| 2. | 226.04 | 239.81 |
| 3. | .54 | .6 |
| 4. | 39634.15 | 43918.91 |
| 5. | 38.46 | 34.88 |
| 6. | 116.07 | 125 |

talking about vale of a $ againt tose not fair vale

flip all

-6

Δ

| | May | June | | |
|---|---|---|---|---|
| 7 | 43.84 | 41.14 | pound - app. | X |
| 8. | 95.18 | 94.05 | yen - app | X |
| 9. | 438.89 | 395 | franc - app | X |
| 10. | 129.51 | 116.18 | C - app | X |
| 11. | 10384.7~~1~~ | 9875 | mork - app | X |
| 12. | 246.88 | 272.41 | paso - dep. | X |

againts $

1. They get more expensive
2. They look like they get cheaper
3. They got cheaper - go faster
4. They got more expensive

72.3.1

F x S+D Michael Plasmeier

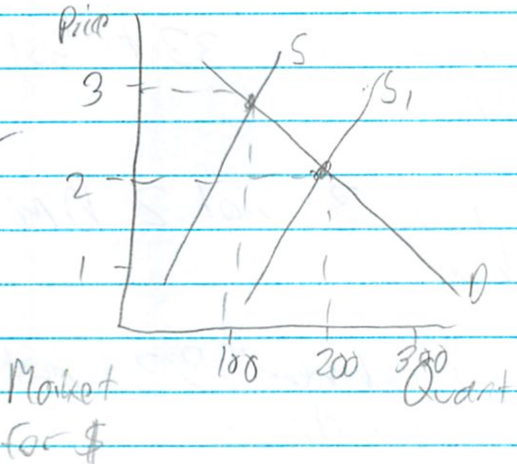
Activity 62

100%

24/24 5/5 1/16

- Learn To Number!

1.




New rate - \$1 = 2 DM

1 DM = \$.50

100 dollars = 200 DM

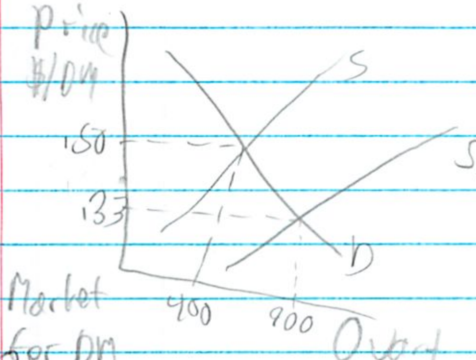
2. Increase - A german will now get \$.13 more Purchasing power per DM

3. Decrease - we now only get 2 DM PP Not 3

4. cheaper - to pay them a dollar, I only need to pay 2 DM not 3

5. Expensive - to pay them each DM in wages - I must now fork over 50 ¢ not 33 ¢

1.




New rate = \$1 = 3 DM

1 DM = .33 \$

100 dollars = 300 DM

2. Decrease - Germans must now pay 3 DM not 2 DM when buying a \$ of goods

72.3.2

B. Increase - Mr. US now only pays 33¢ instead of $.50 for a DM

A. More expensive - must pay 3 not 2 DM for each $ of labor

C. Cheaper - can only pay them $.33 not 50¢ per DM of labor - to demand

73.1.1

USSR + China
Case Study
1/17

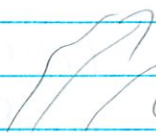
USSR Breakup
21 direct cause: political
growth falling from 5-6% 1950s → 1% right before
poor product quality
tech behind the curve
goods faulty + limited
lack of consumer goods
"social contract" made during war never fulfilled
no reward for past sacrifices
large military burden
15-20% GDP
24 cut off consumer + capital goods
agricultural drag
worker output = 10% of US output
had to import food

25 USSR Transition
Privitation
many former gov things given to private owners
vouchers until 1994 - when cash allowed (foreigners came)
26 Price Reform
resource use efficiency ↑
29 b/c now incentive ↓ costs
got rid of low prices on consumer goods
- said everyone should enjoy them
- but then shortages
30 prices initially surged
currency also unpegged + sank
31 but entreprenures came + ↑ output
Price of Competition
only limited demonoplitization so far
32 →

73, 1, 2

32 Joining the World Economy
opend finance system
curency values stabalized
PL Stabalization
33 transisiton brought hyper-inflation
also people had lots of ruples stored away
but also b/c gov financed debts w/ ↑ $ supply
privatization caused gov to lose revenues
34 disorder + tax avasion
central bank ↓ inflation
36 Major Problems
Falling Output + Living Standards
transition has not paid off w/ ↑ living standards
rapid ↑ inflation caused ↓ investment
unraveling of former trade relationships
bankrupcy of state industiles which could
no longer compete
massive reallocation of resourses
* ↓ real output = ↓ imput
38 Inequality + Social Costs
new wealthy class emerged
some via corruption + crime during transition
"crony capitalism"
Alcoholism ↑ + life expencency ↓

39 Future Prospects
gov has trouble inforcing laws + collecting taxes
hurts gov + gov's credibity
might collapse
or might take off
41



on a path

73,1,3

# China

42 Market Reforms in China
more gradual then Russia's shock
began 1978 + went peacemeal
43 still under direction of communists politically
didn't have same depression
fast growth
44 Agricultural + Rural Reform
70% labor force, rural 1978
leased land to individual farmers
two-track price system
-had to sell to gov at certain price
but rest could sell at "market"
45 by 1990 - 80% sold at market
strengthened incentives
output ↑
46 Urban Reforms
state-owned entprises (SOEs) could set own production #'s
+ keep profits
47 extended 2-track prices
Urban-collectives formed - owned by managers + workers - not subject to central plan
competition spurred advances
49 Special Economic Zones
opened in 1980s to foreign investment
↑ exports
as grew sucessful, more opened
50 Development of Supporting Institutions
made central bank
replaced profit transfers w/ tax system
stock market
currency exchanging places
51 →

73, 1, 4

52 Trans formation of SOEs

In 1990s - became more corperate like

replace party opperatives w/ western-style managers

changed goals from social to economic

(make what people want)

exposed inefficiencies

1997 - call for consolidation + to issue stock

54 but gov still large stock holder

Posted on Fri, Jan. 19, 2007

# The Economy | Where have we heard this warning before?

By Andrew Cassel
Inquirer Columnist

You are forgiven if you tuned into the Federal Reserve Board chairman's Senate testimony yesterday and thought you were watching a rerun.

Yes, the guy at the table this time wore a beard and spoke somewhat less elliptically than his predecessor.

But the substance of Ben S. Bernanke's message to a Senate panel was basically the same one that Alan Greenspan delivered repeatedly for years from that same catbird seat:

The federal budget is cruising toward a waterfall - actually two waterfalls, a small one and a big one.

The small one is called Social Security; the big one is called health care. And if we don't change course soon, we risk a political and economic dunking.

Currently, "we are experiencing what seems likely to be the calm before the storm," Bernanke said of the current federal budget deficit, whose shrinkage last year was much celebrated and largely irrelevant.

It's true, Bernanke noted, that the government's flow of red ink slowed in 2006 to $248 billion from $319 billion a year earlier.

But rather than pat itself on the back, Congress needs to look ahead.

Next year, the first baby boomers will turn 62, and millions will begin claiming their Social Security benefits, followed by Medicare three years later.

Now consider that in 2006, about 40 cents of every federal dollar went to cover the costs of Social Security, Medicare and Medicaid.

The coming baby-boom retirement wave means that spending on those entitlement programs will rise - not just faster than inflation, but faster than the growth of the economy as a whole.

That leaves less money for defense, education, or anything else you might think government should fund.

There are several other choices, but none is pleasant.

Tax hikes won't be limited to the Wall Street bonus-brigade and overstuffed CEOs - the middle class will wind up paying more as well.

Borrowing more won't cut it either, Bernanke said. We're already paying more than $400 billion a year in interest just to service the debt we've got.

By 2030, that debt burden could triple as a percentage of the overall economy - which means the annual interest cost would skyrocket.

Additional borrowing to pay that interest could put us into a fiscal death spiral, resulting in default, runaway inflation, a badly weakened economy, or all three.

So what's left? Some combination of tax hikes, benefit cuts, and reform of the entitlement programs to make them more efficient seems inevitable.

Social Security is actually the easy part. You wouldn't know it from the furious political battle that erupted over President Bush's plan a couple of years ago to partly privatize the retirement system, but left- and right-leaning policy experts have actually found a fair amount of common ground over how to change the program.

A compromise plan would likely involve tweaking the Social Security benefit formula, lifting the cap on payroll taxes, and gradually raising the retirement age in line with seniors' lengthening life expectancies.

Medicare and Medicaid are much thornier issues, mainly because of the broader problem of rising health-care costs for everyone.

Coming up with a fair and effective program that the economy can support probably hangs on a broader change that would affect health-care funding across the board.

But whatever approach Congress takes, it's critical that it get started now.

Every year that the budget isn't balanced puts us deeper in the debt hole, making it that much harder to get out.

The federal deficit also aggravates our international financial imbalance, effectively forcing us to import foreigners' savings to fund both public and private investment.

"The longer we wait, the more severe, the more draconian, the more difficult the objectives are going to be," Bernanke told the senators. "I think the right time to start was about 10 years ago."

No kidding.

## The Economy | Greenspan Admonitions

**November 2005**

He called on Congress to get the nation's fiscal house in order and bring the swollen deficits under control.

"Unless the situation is reversed at some point, these budget trends will cause serious economic disruptions," he said.

**April 2005**

73,22



Large government deficits threaten the U.S. economy, he said, calling on Congress to return to the budget discipline of the 1990s.

"Unless that trend is reversed," Greenspan warned, "at some point, these deficits would cause the economy to stagnate, or worse."

**February 2003**

He questioned the need for a new economic- stimulus package, voicing concern about the rising federal budget deficit. "We ought to be... very careful not to allow deficits to get out of hand."

*SOURCE: Inquirer research*

73, 3, 1



# The Next Meltdown

## It took one act of terrorism in 1914 to cripple the world's financial markets. Why it could happen again

**By NIALL FERGUSON**

IN THE WORLD OF FINANCE, THAT WAS one happy Old Year. Whether they were buying Indian real estate or Brazilian commodities, traders and investors made serious money. Profits at Goldman Sachs exceeded the gross domestic product of Bolivia.

The best explanation for the good times is liquidity. Thanks to global integration and financial innovation, higher short-term interest rates have not translated into monetary tightening. On the contrary, the world economy has been swimming in credit of every conceivable kind. Money-supply figures for the U.S. understate the phenomenon because billions of dollars flow abroad every month to finance the American trade deficit. The world's central banks control about $5 trillion of reserves. This in turn has raised monetary growth rates. The total value of commercial-bank assets worldwide is close to $56 trillion, and bank loans are only one of the many forms credit now takes.

The key question is whether something could happen in 2007 to drain away this liquidity. For most investors and policymakers, the nightmare scenario remains that of the post-1929 Depression, when a stock-market crash was followed by a spectacular wave of bank failures and a massive monetary meltdown. However, by blaming the Hungry Thirties on blunders by the Federal Reserve, we reassure ourselves that history couldn't repeat itself. Today's central bankers are smarter. But history provides an example of another liquidity crisis that went far beyond what central banks could cope with. Until the last week of July, 1914 looked as if it would be another good financial year. The stock-market crash of seven years before had almost faded from memory. Inflation was under control, and interest rates had stabilized. Emerging markets were booming. On the back of sustained global growth, commodity prices were up. Best of all, volatility was as low as most investors could remember. Sound familiar?

CORBIS

Ferdinand's 1914 death sparked war [illegible] panic

It was an act of terrorism on June 28 that began the crisis. At first it seemed like just another assassination in just another Muslim country (Bosnia-Herzegovina, occupied by Austria-Hungary only a few years before). And although the terrorists scored a big hit (Archduke Franz Ferdinand, heir to the Austrian throne), the financial markets took it in their stride. Stocks barely moved.

It was not until the Austrian ultimatum to Serbia on the evening of July 23 that investors began to feel nervous. Its terms were truly formidable, particularly the demand that Austrian officials be allowed into the country to investigate alleged Serbian sponsorship of the terrorists. The government in Belgrade immediately dismissed the ultimatum as "impossible." Germany took the Austrian side; the Russians lined up with the Serbs. By Aug. 4, a little Balkan *difficulty* had become a full-scale European war.

The financial crisis happened even faster. Within days of the Austrian ultimatum, the delicate web of international credit was torn to shreds. German trading companies ceased to remit the money they owed to brokers in London. European investors rushed to withdraw their money from New York. As nervous banks called in loans, panic selling swept the world's financial markets. But the further asset prices fell, the worse the crisis became. Securities that had been the collateral for immense pyramids of debt were suddenly unsellable. The central banks had to admit they lacked the means to stem the outflow. The only way to avoid a complete financial implosion was literally to close the world's stock exchanges. London's exchange remained shut down until January 1915.

Could such a "great drain" happen again, sucking liquidity out of the international financial system? Many experts would dismiss the idea as mere doom mongering. A full-scale war, they say, is one of those "10-sigma" (10 standard deviation) events that are so rare they lie outside the domain of risk management. Like an asteroid hitting the earth or a global influenza pandemic, a really big war belongs in the realm of uncertainty. You just can't price it in.

But try rereading the events of 1914 with the place names changed. Imagine the assassination of the U.S. Vice President in Baghdad this coming June. The U.S. suspects Iranian involvement and sends an ultimatum to Tehran. Israel takes the American side; Russia lines up with the Iranians ... It's not a wholly implausible sequence. And some central bankers admit privately that they would have to struggle to counter the liquidity crunch that such a geopolitical shock would trigger. A stock-market shutdown in 2007? History warns us not to rule it out. ■

**IT SEEMED LIKE JUST ANOTHER ASSASSINATION IN JUST ANOTHER MUSLIM COUNTRY. STOCKS BARELY MOVED**

*Ferguson is the Laurence A. Tisch Professor of History at Harvard University*



but it's not world power vs. world power anymore – China?

73, 4, 1

A.P. Macroeconomics Dr. Reilly

**Exam Review Questions**

DIRECTIONS: Having completed this course, you should be able to answer the following questions—especially if you plan to take the A.P. Macro exam on May 18. They are for review, not for a grade. These questions are adapted from a description of the A.P. Macro exam published by the College Board.

I. Basic Concepts

A. Define and illustrate scarcity.

B. Define and illustrate opportunity cost.

C. Define and illustrate comparative advantage from

1. differences in output levels and
2. differences in labor costs

D. Define and illustrate the functions performed by an economic system.

E. Define and illustrate the different types of economic systems.

F. Explain and illustrate how demand-supply analysis can be used to analyze a market economy.

II. Measurement of Economic Performance

A. Define GNP and GDP.

B. Define inflation.

C. Define unemployment in general and in its three types.

D. How is unemployment measured?

E. Explain the seeming paradox of a positive unemployment rate when there is so-called "full employment."

F. Explain the measurement of gross income.

G. Explain the costs of inflation.

H. Explain the costs of unemployment.

I. Explain the difference between nominal and real values.

J. Explain how a price index converts nominal magnitudes into real magnitudes.

K. Speak accurately about the historical and actual levels of inflation. unemployment. GDP in America and how changes in any one may affect the others.

III. National Income and Price Determination

A. Explain the nature and graph the shape of the AD and AS curves.

B. Explain the differences between the Keynesian, classical, and neo-classical (rational expectations) views of the shape of the AS curve and the importance of the shape in determining the effect of changes in aggregate demand on the economy.

C. Explain and illustrate the circular flow of goods and earnings in the economy.

D. Use a model to explain the how equilibrium determines the aggregate price level and output.

E. Explain and use a model to demonstrate the spending multiplier.

F. Explain the effect of government fiscal policy on aggregate demand and the differing effects of discretionary tax and expenditure policies.

G. Identify and discuss the role of automatic stabilizers.

73, 4, 2

II. National Income and Price Determination (continued)

H. Define money according to its role and composition of its various measurements.
I. Explain the fractional reserve banking system.
J. Explain multiple-deposit expansion and money creation.
K. Explain the structure and functioning of the Federal Reserve System.
L. Identify and explain the Fed's tools of monetary policy.
M. Define the determinants of demand for money.
N. Explain and graph how equilibrium in the money markets determines the interest rates.
O. Explain and graph how the investment demand curve provides the link between changes in the money market and changes in aggregate demand.
P. Explain and graph how monetary and fiscal policies interact.
Q. Explain and graph "crowding out" and how it might be countered.
R. Describe the issues on which Keynesians and monetarists disagree.
S. Describe the economic effects f government budget deficits.
T. Explain the issues involved in determining the burden of the national debt.
U. Explain the relationship between deficits, interest rates, and inflation.
V. Explain why the AS curve may be upward-sloping in the short-run but vertical in the long-run.
W. Explain the difference between short-run and long-run impacts of monetary and fiscal policies.
X. Trace the short-run and long-run effects of supply shocks.
Y. State and analyze the short-run and long-run Phillips curve relationships.
Z. Explain inflationary expectations and how Keynesians , monetarists, and neo-classical economists differ over them.

IV. Growth

A. Describe the contributions of economic growth to job creation and economic well-being.
B. State the determinants of economic growth.
C. Explain the impact of monetary and fiscal policies on the growth of a nation's economy.

V. International Finance, Exchange Rates, and Balance of Payments.

A. Explain how the combination of monetary and fiscal policies used in addressing problems of inflation and unemployment has an affect on international factors such as exchange rates and the balance of payments.
B. Explain how international forces, often beyond the control of a country's authorities, effects a country's exchange rates, which in turn effect price level, unemployment, and level of output.
C. Describe the effects of trade restrictions.
D. Explain how the international payments system hinders or facilitates trade.
E. Explain how domestic policy affects international finance and trade.
F. Explain how international exchange rates affect domestic policy goals.

73.4.3

# MACROECONOMICS

## SECTION II

**Planning Time—10 minutes**

**Writing Time—50 minutes**

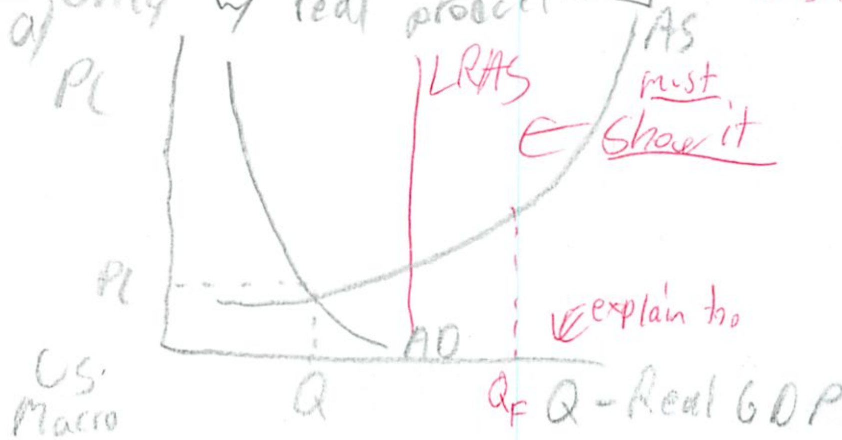
**Directions:** You have fifty minutes to answer all three of the following questions. It is suggested that you spend approximately half your time on the first question and divide the remaining time equally between the next two questions. In answering the questions, you should emphasize the line of reasoning that generated your results; it is not enough to list the results of your analysis. Include correctly labeled diagrams, if useful or required, in explaining your answers. A correctly labeled diagram must have all axes and curves clearly labeled and must show directional changes.

7/10

1. Suppose that the United States economy is in a deep recession.
   - (a) Using a correctly labeled aggregate demand and aggregate supply graph, show the equilibrium price level and real gross domestic product.
   - (b) There is a debate in Congress as to whether to decrease personal income taxes by a given amount or to increase government purchases by this amount. Which of these two fiscal policies will have a larger impact on real gross domestic product? Explain.
   - (c) Explain how a decrease in personal income taxes will affect each of the following in the short run.
     - (i) Consumption ↑ DI ↑
     - (ii) Real gross domestic product and the price level ↑ AD ↑
     - (iii) Imports ↑ } b/c ↑C
     - (iv) Exports ~~↑~~ ↓ b/c app $ ↓ exports, ↑ Domestic PL ↓ (−1)
   - (d) Explain the mechanism by which an increase in net investment will cause each of the following to change.
     - (i) Aggregate demand $ invested in capital
     - (ii) Long-run aggregate supply — Only w/ real production Δ ← but this does ↑ LRAS (−1)

Long Stabalization | Short 37+38 chaps

a)




US Macro Econ

b) Part of taxes goes to savings - dosn't help ↑ C

G > T ← give answer

74,1,1 - Last day!

# Russia + China Prospects

1/18

58 Positive Outcomes - China
highest growth in past 20 years
econ doubles every 20 years
Farmer ↑ productivity + income
59 exports ↑ too
per-capita growth also very high
Changes slow - so little unemployment

00 China Problems
Incomplete Property Rights
after inital surge - agriculture productivity slow
gov only leases land for 15 years
w/o ownship - farmers afraid to buy land
02 Macro Instabity
Sometimes too much spending
SOEs owe a lot of $
03 Integration into the Global Econ
needs to join WTO - Update: has
needs to protect intelectual property laws
04 Geographically Uneven Development
Hong Kong wealthy, so is south + coastal cities

04 Conclusion
China + Russia taken different paths
China currently looks to have come out on top
but Russia may be better off w/ democracy
06

Last Word →

79.1.2

06 Last Word: "I think everything will be Ok"
Pastry company transitioning to market

08 At 1st - hard: no sales + marketing experience
But new manager focuses on customers
wants - now much better quality +
capital (mixer + refritgarater) to make
"life eaiser"

10
Done!

74,2,1 ...rategy

'3


AP

On China
POLITICS & ECONOMICS | A6

THE JOURNAL REPORT


# ...E WALL STREET JOURNAL.

MONDAY, JANUARY 22, 2007 ~ VOL. CCXLIX NO. 17 ★★★


...ASDAQ 2451.31 ▼2.1% NIKKEI 17310.44 ▲1.5% DJ STOXX 50 3781.45 ▲0.3% 10-YR TREASURY ▼1/32, yield 4.773% OIL $51.99 ▼$1.00 EURO $1.2963 YEN 12...

## News–

* * *

*World-Wide*

■ **Bush promoted a tax plan to pay for health care, a top voter concern.** In a bid to tackle health-care inflation, Bush will seek to extend tax deductions for health coverage to everyone who buys it outside the workplace but count employer-provided health insurance benefits as part of income, making them taxable. The president flagged the plan in his Saturday radio address and will elaborate in his State of the Union address tomorrow, officials say. A new Wall Street Journal/NBC survey found a 33% plurality of Americans calls the cost of health care the economic issue that concerns them the most. **A2**

*Bush also hinted in his radio address at an initiative to encourage states to create insurance pools for the poor, as he faces pressure to address the needs of all of America's uninsured.*

* * *

■ **U.S. troops in Iraq suffered** their deadliest day in two years Saturday, a toll of 25 dead, 12 in a Black Hawk helicopter crash in Diyala province.

■ **Shiite leader Sadr ended** a two-month boycott of Iraq's government.

* * *

■ **Sen. Clinton declared** her bid for the presidency in an online posting Saturday, and New Mexico Gov. Richardson followed her into the Democratic fray yesterday. Sen. Brownback (R., Kan.) also declared. **A4**

* * *

■ **Russia's Putin promised** smooth energy flow to Europe, after talks with Merkel. Despite European concerns, investors credit Putin for the Russian market's rally, and the German leader acknowledged in an interview the Continent can't manage without Moscow's goods. **A1 and A3**

■ **Russia warned** of an arms race as

## *In Nazi Camps, Counterfeiting Ring Saved Mr. Burger*

* * *

### Today a Movie and Book Recount a Massive Plot To Weaken British Pound

By Marcus Walker And Almut Schoenfeld

PRAGUE—Adolf Burger, a sprightly 89-year-old survivor of Nazi concentration camps, held up one of the British £5 notes he helped forge for the Germans during the war.

"Britannia was hard" to render, he said, pointing to the female symbol of Great Britain, a toga-wearing woman with spear and shield drawn in the note's top left-hand corner.


*Adolf Burger*

Mr. Burger was a reluctant player in one of the biggest attempts at financial sabotage in history. The Nazis forced Mr. Burger and 140 other Jewish prisoners—all marked for liquidation—to forge so much British currency that by 1945, 12% of all pound-sterling bills in existence, measured by face value, were fake.

Mr. Burger published a short memoir after the war, and then didn't talk about the war for decades, he says. In the 1970s, a book by a German Holocaust denier so incensed him that he took early retirement and began collecting photos and documents to prove what he had seen in the concen-

*Please turn to page A13*

**EDIFICE COMPLEX**

## In Real-Estate Battl... Titans Awash in Cas...

### *Though Equity Office Was Poor Performer, Mr. Roth Covets It*

By Jennifer S. Forsyth

Last July, Steven Roth called fellow real-estate titan Sam Zell with a secret proposal: a merger that would put the two longtime friends atop a company that would dwarf anything else in the real-estate world.

Mr. Roth, chief executive of Vornado Realty Trust, knew that Mr. Zell's Equity Office Properties Trust was in play. EOP—the nation's biggest office landlord, with more than 590 buildings—had been a disappointment on Wall Street. Mr. Zell thought he could get efficiencies from owning big buildings en masse, but had ended up paying too much for some buildings and owning in too many weak markets. With its stock trading at less than the value of its assets, EOP had become likely prey for cash-rich private-equity firms that could carve it up and sell it off.

But Mr. Zell's company would be a boon for Vornado. With successful investments in real-estate and beyond, it was drowning in capital—and a combination with EOP would give Vornado a myriad of choice properties in one fell swoop, at a time when competition has never been more fierce for commercial estate. He thought Mr. Zell, 65 years old, would leap at the chance to keep his empire intact, married to Vornado's powerful financial machine.

Mr. Roth guessed wrong. In November, after negotiations bogged down over price, Mr. Zell agreed t... company for $20.1 billion to... private-equity firm, Bl... Group. Mr. Zell declined to... viewed.

Now, Vornado is scrambl... back into the deal. Last wee... York-based real-estate ir... trust teamed with two partı... Blackstone's bid by 7%. If i... ceeds, Vo... cherrypi... EOP's ma... take M... throne a... tion's lar... building...


*Steven Roth*

Vorn... Blackst... squaring... ant take... fueled... wave of... ing thr... markets. Low interest rat... global economy and high... prices have flooded coffer... world with cash that inves... creasingly sought to put... sets such as office buildi...

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# Business

VEDNESDAY, JANUARY 24, 2007 C The Philadelphia Inquirer WWW.PH

| Most Active Local Stock | Dow Jones Industrials | Nasdaq Composite | Standard & Poor's 500 | 10-Year Treasury Note | $1 = |
|---|---|---|---|---|---|
| DuPont $49.67 Down 43 cents, 0.86% | 12,533.80 Up 56.64 0.45% | 2,431.41 Up 0.34, 0.01% | 1,427.99 Up 5.04, 0.35% | 4.71 yield Down 0.05 | 0.7680 Euro (; 121.64 Yen ( |

*Charles I. Plosser has a comfort zone. He's not in it now.*

## Inflation nags at Phila. Fed chief

**Andrew Cassel**
*The Economy*

You could say Charles Plosser is excited about being president of the Federal Reserve Bank of Philadelphia. Or you could say he's feeling engaged, challenged, and generally optimistic overall.

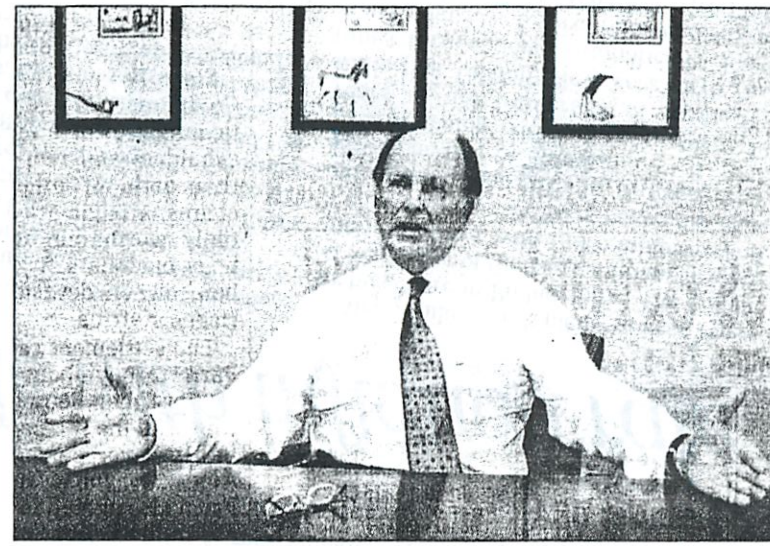
But you can't say he's comfortable.

His discomfort stems from the current level of inflation — specifically the "core" rate that Fed officials rely on to gauge their effectiveness as guardians of the nation's monetary stability. During 2006, core inflation clocked in at 2.8 percent, and while that's pretty tame compared with some eras we can recall (think the 1970s), it's a bit too high for people who consider themselves hardcore inflation-fighters, as Plosser does.

But how much is "a bit"? How far would inflation have to fall to be inside what Fed-watchers call the "comfort zone"? Plosser won't say.

"I haven't given my comfort zone. I'm not going to reveal it," he told me in an interview last week. He does, however, stand by remarks he made last fall as part of his first public speech since becoming Philadelphia

See **CASSEL** on C6



JOHN COSTELLO / Inquirer Staff Photographer

**Fed Ba**
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# Recapturing a Sugar High

# Penn Heal System to buy Gradu

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times after its acquisition by the now-bankrupt Allegheny health system in 1996.

"This is a venerable institution with a rich legacy of patient care and physician education," Haber said. "I think it deserves better than what is going to happen."

The hospital will remain open until the sale is completed March 30, but new admissions will stop by the end of February.

At that time, a temporary urgent-care center will open in place of the emergency room. Campanini said these were all steps to prepare the hospital for the transition from acute care.

While the Philadelphia area has several prominent rehabilitation hospitals, local experts say they do not expect another to increase competition among the region's hospital networks.

"I don't see any aspect of this deal that doesn't make sense," said Alan M. Zuckerman, president of Health Strategies & Solutions Inc., of Philadelphia.

Tenet acquired Graduate along with seven other local hospitals from Allegheny in November 1998.

Yesterday, Graduate employees received an open letter from hospital chief executive Brian Finestein informing them they would have opportunities to transfer to other Tenet hospitals or apply for jobs in the Penn health system.

"Job fairs, employment counseling and appropriate severance will be provided by Tenet to those employees who do not receive offers of comparable employment," he wrote.

That is small solace to Henry Nicholas, president of the union that represents about 200 of Graduate's 400 employees.

"They don't intend to reopen with any of the former employees," Nicholas said. "It means that we lose about 400 jobs in South Philly, which is a big loss. Job fairs don't fill that capacity."

Good Shepherd Penn Partners, the new venture, should employ about 450 people by its second year, said Sally Gammon, president of the Good Shepherd Rehabilitation network.

Contact staff writer Josh Goldstein at 215-854-4733 or jgoldstein@phillynews.com.

| | Hospital of the University of Pennsylvania | Presbyterian Medical Center | Pennsylvania Hospital |
|---|---|---|---|
| Total revenue in millions* | $1,164 | $353 | $371 |
| Licensed beds | 695 | 347 | 500 |
| Employees | 5,601 | 1,576 | 2,416 |
| Physicians | 1,650 | 854 | 859 |
| Patient admissions | 36,518 | 14,957 | 23,054 |

*Fiscal year ending June 30, 2006

SOURCE: University of Pennsylvania Health System

The Philadelphia Inquirer

flagship facility for a five-hospital health system.

**1996** Graduate and its affiliated hospitals become part of the Pittsburgh-based Allegheny health system.

Shepherd Rehabilitation announce a joint venture to convert Graduate into a long-term acute care and rehabilitation hospital to be reopened in July 2008.

# Phila. Fed chief uncomfortable with inflation rate

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**CASSEL** from C1

Fed president in August:

"At that time, core inflation was running about 2.5 percent. That's higher than I'd like to see it.'"

There's more to this than simple academic musing. Being president of the Philadelphia Fed makes Plosser a member of the Federal Reserve's key Open Market Committee, which sets the course for U.S. interest rates — and, to some extent, the pace of the overall economy.

Although Plosser won't actually cast a vote on interest rates until 2008 — voting power rotates among the regional Fed presidents — his voice will be heard whenever the panel meets in Washington. Already, some professional Fed-watchers have called Plosser among the most hawkish — that is, the least inflation-tolerant — of all the central bank's key players.

"Certainly, I'm not a fan of inflation," Plosser told me.

The thing is, "there's only one institution in our government that has the ability to control inflation. That's the Federal Reserve. So I think it's important that the central bank take that charge very seriously."

How seriously is a question we could see play out later this year.

Analysts and financial markets are divided over the outlook, with some saying the economy has slowed enough to justify a Fed rate cut, while others believe rates will stay firm or even rise.

The key, however, is how Fed officials themselves see it. And since their deliberations are never public — minutes of the central committee meetings are released long afterward — Fed-watchers pick over officials' public statements intently for signs of what's to come.

That could change. One idea being debated among Fed officials is to introduce an explicit target for inflation. Then, if prices were rising faster than the target rate, investors and business planners would know to expect an increase in short-term interest rates.

Former Fed Chairman Alan Greenspan opposed the idea during his 18-year tenure, which ended in February 2006, arguing that the bank needed the discretion to deal with changing economic conditions. But Plosser, among others, questions whether that's appropriate for a post-Greenspan Fed.

"You can't take issue with [Greenspan's] success," he said.

But, he added, "there's no little black book in the upper-right-hand corner of the desk drawer that tells you how you make monetary policy like Alan Greenspan."

Ben S. Bernanke, Greenspan's successor, has endorsed naming an inflation target, and Plosser supports the idea "as a philosophical statement." But getting such a change through the Fed's cautious bureaucracy might take some time.

Meanwhile, there's plenty to keep Plosser busy here in Philadelphia. The regional Fed is one of the biggest financial institutions in town, with 1,100 employees and a charge to oversee local banks throughout eastern Pennsylvania, southern New Jersey, and all of Delaware.

An Alabama native, Plosser spent 28 years at the University of Rochester while that Upstate New York city's fortunes turned down dramatically. Eastman Kodak Co., for example, had 50,000 workers there when Plosser arrived but just 10,000 when he left.

While Philadelphia has "a wealth of talent," he said, some of the issues here are similar. "One of the things many older communities face is, how do you promote and retain talented individuals?" Plosser said.

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Michael Plasmeier

Riley

AP Macro Econ

22 Jan 2007

Travels of a Global T-Shirt Book Report

*The Travels of a T-Shirt in the Global Economy: An Economist Examines the Markets, Power, and Politics of World Trade* explains the story (and politics) behind what it takes to produce a T-Shirt to be sold in America. The author, a collage e professor at Georgetown University was inspired to take this journey after observing an anti-globalization protest in 1999. The first step in her journey was the cotton fields of Texas. Technology and subsidies means that a lot of cotton is grown right here in America. Then the cotton gets graded through a very scientific process and shipped to China. In China, the the state-run factories must cope with producing for a market not a quota. They get help from the workers, who despite having limited mobility feel very happy to work in a factory over a farm. This is similar to the long-gone British and American textile industries. Coming back to America, the shirt encounters a mess of tariffs and quotas. Despite promising free trade, the politicians have developed thousands and thousands of laws regarding textile imports. However, when she is done with her shirt, it finally encounters a free market in the highly competitive fabric recycling industry.

Avoid colloquialisms. They limit your audience.

Avoid "very."

This book was very interesting. All of the problems with T-shirts today stem from our long problem with protectionism. The problem is that all of the non-market activities drive up the cost and complexity of making a shirt. The story of how the US producers have always tried to avoid free markets is very, very interesting. In addition, the fact that Chinese workers rather work in a factory over a farm for independence surprises me. The activists should consider this when they talk about "sweatshops." I also learned how picky African buyers are with everything we donate. This book should be read by every person against the concept of globalization.

I was doing a report on globalization in World Cultures so I was e very interested on the topic. In addition, we learned about the dangers of tariffs and quotas in The Choice as well as in class. This talks about the effects which these protectionist policies actually had and sort-of continue to do so because of the one powerful "alphabet army" of lobbyists.

Underline the titles of books.

The author of the review e very much liked the book. He said that "has all the makings of an economic classic." I agree. We should give up the protests against global trade and focus on giving these people a free market to trade these goods. "She uses the T-shirt to tell the story of progress." Again I agree. The textile industry has always tried to avoid free markets. Especially with the cotton industry, it tells how the market adapts and changes. He said other books have made these points, but this one tries to work at a level anyone can understand because it tells the actual stories of people which the T-shirt industry touches.

Since you italicized the title earlier, follow that style.

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Titles of books, newspapers, and magazines are ~~[illegible]~~ italicized or underlined.

Omit the detailed URL.

Excellent content. See my comments on style.

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Michael Plasmeier

Riley

AP Macro Econ

12 Jan 2007

The titles of books, magazines and newspapers are always underlined.

Nickel and Dimed Book Report

Summary

Nickel and Dimed is about a well-off author, Barbara Enrenreich, and her experience when she sets aside her college education, white collar job, and joins the ranks of workers living near minimum wage. During her experiment, she struggles to just get by; becoming ever more hopeless toward the end. She jumps from job to job, always searching the want ads for opportunities, and avoiding the wrath of the management. She points out the problem of the poor, without enough money upfront, they are stuck paying much higher amounts for housing and enormous rates on credit cards to live paycheck to paycheck. In addition, firms are only interested in hiring drug-free people good at following orders. Affordable housing is very, very hard to come by she finds. Overall, her experiences were less the positive.

Avoid "very."

My Review

Nickel and Dimed scared me into making sure I get a good education, and a good, well paying, white collar job. In addition, I will never look at a service person the same way again. They go through so much, and make so little. Even buying a uniform for their next job puts them weeks behind in savings. These people seem to live in a different country then us, both because of their standard of living, and how much we hear about them. Next time, I will definitely support raising the minimum wage. In addition, tips are a large part of wages for servers; should remember that as I start eating out without my family.

Overall, I enjoyed reading the book a lot. When I first read it I could not put it down. I read all of it in one day. I seem to enjoy books like this, giving a view inside American society, and how it works. The book is very well written and describes her experiences almost perfectly, without becoming repetitive. I appreciate the facts she intersperses with her story. Overall, I would highly recommend that other read the book in order to gain the same insight which I did.

Connection

Nickel and Dimed is about the income inequality which exists in the American economy. The book talks about "market" conditions do not mirror real life. Economics assumes that people will have all of the ideas they need to make a smart choice. But the wage taboo prevents wages from being discussed. Help wanted ads are always posted, and almost all don't offer hard numbers. Job searches take time, which can be better spent working. So the actual plight of the poor differs from textbook assumptions and models. This book tells the important human cost of low wages, which is missing in most textbooks.

Reviews

The review I read from The ~~Humorist~~ Humanist starts out not liking the book, but ends up enjoying the book very much. The reviewer even goes as far as to say, "this book should be required reading for corporate executives and politicians." I agree. The people who make the decisions about welfare programs and the entry-level wages so be aware just how far those wages go in today's society. They should realize how they are barely paying subsistent wages and should have a little humanity before they protest minimum wage increases. And the politicians should understand that minimum wages do matter to some people; they should pass increases regardless of the protests. Political should also realize how real welfare cuts hit home with a large part of America.

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Excellent Review!
I'm glad you enjoyed the book
AT

I'm glad you enjoyed the book

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