1) a) If a country has a trade deficit are its “net exports” positive or negative?
   b) What is a tariff? What is a quota? How will each affect a country’s imports?
   c) What role has the General Agreement on Tariffs and Trade had on tariff changes in the last 30 years?
   d) What are two types of net foreign investment?
   e) On page 373 the text lists four things that affect the level of foreign investment. What are they? Is the exchange rate one of them?
   f) What happens to the U.S. level of net foreign investment if non-residents reduce the amount of U.S. stock they own?
   g) What does it mean for a borrower to default on debt?
   h) Why does the economist Paul Krugman believe increased imports from poor countries will not reduce U.S. wages much?
   i) In the 1980s what happened to i) U.S. national savings rate; ii) net foreign investment; and iii) U.S. real interest rates?
   j) Suppose the exchange rate is 100 ¥/$. How many U.S. dollars would be needed to buy one Yen?
   k) Did the dollar appreciate or depreciate if the exchange rate in (j) changed to 150 ¥/$. How about the Yen?
   l) If a typical basket of goods costs 450 ¥ in Japan and the same basket costs $3 in the U.S., and the nominal exchange rate is 100 ¥/$ - Then what is the real exchange rate. How many (in fractions) Japanese baskets can be “purchased” with one U.S. basket?
   m) If nominal exchange rate is fixed and U.S. prices rise while Japanese prices remain constant, what happens to the real exchange rate?
   n) If purchasing power parity is true, what is the nominal exchange rate (¥/$) if something that costs 160 Yen in Japan costs $2.00 in the U.S.?
   o) If purchasing power parity holds (is true) and the nominal exchange rate is 2.5 German Mark (DM) per U.S. Dollar ($), and one burger costs $2.00 in the U.S. how much should this burger cost in Germany?
   p) What is the relationship between the law of one price and purchasing power parity?
   q) Distinguish between a “debtor” and a “net debtor.”

2) a) Chapter 18 presents a model for the market for loanable funds. What is on the vertical axis? Who are the demanders of loanable funds? Who are the suppliers?
   b) Distinguish between Net Foreign Investment and Foreign Investment. Distinguish between Exports and Net Exports. Why does Net Foreign Investment = Net Exports?
   c) Explain the equation S = I + NFI (on pg. 397) in words. What are two components of S? If government has a budget deficit, what is true of net public saving. Is saving in this context a stock or flow variable?
   d) In diagram 18-4 (pg. 398) why does the level of net foreign investment fall as the real interest rate increases?
   e) Show the effect of an increase in a government budget surplus using the model in Ch 18. Realize this it the opposite of what is shown in Figure 18-5 (pg. 401)
   f) In the Ch 18 model an increase in tariffs does not reduce net exports - Why? Is the level of imports and/or exports affected by this increase in tariffs. Is the level of net exports affected?
   g) What is a quota? How is it related to a “Voluntary Export Restraint.”

3) Use the model in Figure 18-7 (pg. 405) for this problem:
   a) In the textbook description of “capital flight” what happens to the total amount of loans being made by lenders after the increase in political instability in Mexico? What do borrowers do with the money they borrow in Mexico?
   b) One can think of capital flight from Mexico as involving Mexicans removing pesos from Mexican banks and selling the Pesos for U.S. dollars which they invest in the U.S. This would shift the supply of loanable funds in Mexico left rather than the demand right as shown in the text. Would the change in real interest rate be different? How would the Net Foreign Investment curve shift. What does this indicate? If more Mexicans want to sell Pesos for Dollars, what happens to the Supply of Pesos and to the Real Exchange Rate?
4) Give three reasons why the Aggregate Demand (AD) curve is downward sloping. Give three reasons the Short Run Aggregate Supply (SRAS) curve is upward sloping. What is held fixed moving along a AD curve and what is held fixed along a SRAS curve? Contrast an increase in real wealth due to a stock market boom with an increase caused by a fall in the price level.

5) Why would length of wage contracts influence how quickly the Short Run Aggregate Supply will shift? Why is the SRAS curve upward sloping and the LRAS vertical?

6) What typically happens to unemployment, output (real GDP), interest rates, and inflation in an economic expansion? - In an economic contraction?

7) a) What does the term *animal spirits* mean in the Keynesian model? How could a change in these animal spirits cause a recession. Which component of Aggregate Demand (C, I, G or NX) is initially most affected by a change in animal spirits?
   b) If an economy is in a recession, is the intersection of the AD and SRAS to the right or left of the LRAS Curve? How does an economy in recession move to the long run equilibrium?
   c) In the Aggregate Demand and Supply model, what happens if wages fall? Will it stabilize the economy (push it back to long run equilibrium) if wages fall during a recession? Why or why not?
   d) What is not held constant as we trace out an AD or SRAS curve?
   e) What can shift the LRAS rightward? How is this related to shifts in the Production Possibilities Frontier?
   f) Give an example of an automatic stabilizer. How does this automatic stabilizer change in a recession?
   g) Would a regressive tax serve as an automatic stabilizer?
   h) In what direction does a tax cut (reduction in taxes collected) shift AD curve? Why?
   i) If a tax cut led to people working more, what would happen to the LRAS (and SRAS) curve(s)? Why?

8) a) If inflation is zero, how is nominal interest affected if the real interest rate increases by 2%?
   b) In the theory of *liquidity preference* presented in Chapter 20 there is no distinction between nominal and real interest rates. How do changes in the interest rate cause changes in the quantity of money people want to hold?
   c) If money supply increases, what happens to interest rate? And then what happens to AD curve and why?
   d) What is the *federal funds rate*? How does it change if the money supply increases? Would the Fed want to increase or decrease the fed funds rate in a recession if they were using “counter cyclic policy” to stabilize the economy?
   e) One Fed chairman said his job was to “take away the punch bowl just as the party gets going.” Explain this analogy. Why would he want to do this?
   f) Why might the Fed want to increase interest rates if stock prices were increasing rapidly due to “irrational exuberance” or “speculation.”
   g) Describe how the spending multiplier is related to the effect of an increase in government spending. All else constant, how would a smaller *marginal propensity to consume* affect the degree to which AD shifts when government spending increases?
   h) Describe the crowding out effect. If there is “complete crowding out” will the AD shift as Government spending changes?
   i) A theory called *Ricardian Equivalence* suggests that people will increase saving if government increases deficit spending so they will be better able to pay higher expected future taxes. If this happens, how would the result be similar to crowding out? Thus could “crowding out” occur without an increase in interest rates?
   j) What does it mean to say the marginal propensity to consume = .9? What is the *spending multiplier* if the marginal propensity to consume is .9?

9) a) What is a *fiscal deficit* and how is it related to the *national debt*. What is a *trade deficit*?
   b) Classical Economists can be said to believe “supply creates its own demand” (this is called Say’s law); and Keynesians to believe that “demand creates its own supply.” How does this relate to the emphasis that Keynesians give to AD, and Classical economists to AS curves?
   c) If policy was *counter-cyclic*, what kind of monetary and fiscal policy would be used in an expansion (boom)? Who would undertake this policy?