"It's one of those *Circle of Life* kind of things..." -- Hopper

MR. WEBB'S SLAM-BANG ECONOMICS WHIZ-ZAPPER

Everything we've studied is related to everything else. Interest rates, aggregate demand, money supply: it's all interconnected. Seriously. So here's what you do... get some paper out and draw up all the relations. Follow this prescription for knowledge, and you can't go astray on an FRQ! (HINT: Answer as much of the non-graph questions in the form of a chart or table as you can!)

1. Draw a circular-flow model. Have money travel in a clockwise direction on the interior and goods, services, and resources going counter-clockwise on the outside. Put a meddlesome government in the middle. Notice how everything balances out nicely. Note that whenever a question asks about balance, you can draw this chart for some help in your explanation.

2. Draw an AS/AD chart showing an economy in recession. Draw another showing the economy doing just fine. Draw a third showing the economy experiencing full-output and inflation. These are the three possible starting conditions in questions that deal with the economy.

3. Draw a money-market graph showing an increase in the money supply. Draw another showing a decrease in the money supply. That's all we can do with money supply: increase it or decrease it.

4. Flow chart time... Each change made to the economy will have a ripple effect on other stuff. Time to chart them *ALL* out. I'll enumerate them here for you, but if I left some off, we can always add more. Things are affected in the order they're listed, so remember the relationships as you write them out.

a. Increase Gov't spending (fiscal policy): How does this affect AD? Interest rates? Investment? Imports? Exports?
b. Decrease Gov't spending (fiscal policy): How does this affect AD? Interest rates? Investment? Imports? Exports?
c. Increase taxes (fiscal policy): How does this affect AD? Interest rates? Investment? Imports? Exports? Why is this not as effective as decreasing spending?
d. Decrease taxes (fiscal policy): How does this affect AD? Interest rates? Investment? Imports? Exports? Why is this not as effective as increasing spending?
e. The Fed buys bonds (open-market operation and also monetary policy): How does this affect The supply of money? Interest rates? Investment? Imports? Exports? AD?
f. The Fed sells bonds (open-market operation and also monetary policy): How does this affect The supply of money? Interest rates? Investment? Imports? Exports? AD?
g. The Fed raises the reserve requirement (monetary policy): How does this affect banks' ability to lend money? The supply of money? Interest Rates? Investment? Imports? Exports? AD?
h. The Fed lowers the reserve requirement (monetary policy): How does this affect banks' ability to lend money? The supply of money? Interest Rates? Investment? Imports? Exports? AD?
i. The Fed lowers the Discount Rate (monetary policy): How does this affect banks' ability to lend money? The supply of money? Interest Rates? Investment? Imports? Exports? AD?
j. The Fed raises the Discount Rate (monetary policy): How does this affect banks' ability to lend money? The supply of money? Interest Rates? Investment? Imports? Exports? AD?

5. Time for the supply side: What happens to AS, LRAS, the overall rate of growth, and the PPC when each of these changes hit the economy:
a. Improvement in technology
b. Increase in investment
c. Reduction in price of land, labor, capital, entrepreneurial talent, or natural resources
d. Reduction in business taxes
e. Improvement in productivity
f. Decrease in investment
g. Increase in price of land, labor, capital, entrepreneurial talent, or natural resources
h. Increase in business taxes

6. International trade: Assume two currencies, one for Country A and one for Country B.
a. Country A's interest rates go up. How will that affect A's imports? A's exports? B's imports? B's exports? A's purchasing power? B's purchasing power? Capital flows to A? Capital flows to B?
b. Country A's interest rates go down. How will that affect A's imports? A's exports? B's imports? B's exports? A's purchasing power? B's purchasing power? Capital flows to A? Capital flows to B?
c. Country B's interest rates go up. How will that affect A's imports? A's exports? B's imports? B's exports? A's purchasing power? B's purchasing power? Capital flows to A? Capital flows to B?
d Country B's interest rates go down. How will that affect A's imports? A's exports? B's imports? B's exports? A's purchasing power? B's purchasing power? Capital flows to A? Capital flows to B?
e. Country A demands more goods from Country B. How will this affect the supply of A's currency? Demand for A's currency? Supply of B's currency? Demand for B's currency? Interest rates in Country A? Interest rates in Country B?
f. Country A demands more goods from Country B. How will this affect the supply of A's currency? Demand for A's currency? Supply of B's currency? Demand for B's currency? Interest rates in Country A? Interest rates in Country B?