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| **AP Macroeconomics**  Mrs. Shackett  Monetary and Fiscal Policy Effects | Name |

1. Assume the government gives businesses a big tax credit on capital investment. Circle the correct symbol (↑ for increase, ↓ for decrease) to indicate what will happen to the following as a result of the tax credit.
2. Capital investment ↑ ↓
3. AD ↑ ↓
4. The amount of capital available to labor ↑ ↓
5. Productivity ↑ ↓
6. Firms’ unit cost of production ↑ ↓
7. SRAS ↑ ↓
8. LRAS ↑ ↓
9. Real Gross Domestic Product ↑ ↓
10. Graph the scenario above on a fully-labeled AS/AD diagram.
11. How will firms’ unit cost of production change when there is an increase in government regulation? Create a fully-labeled AS/AD diagram to show the effect.
12. Assume that the economy suffers a negative supply shock and that input prices are completely flexible. In the absence of any fiscal or monetary policy, explain how the economy will return to full employment. To help you reach the correct conclusion, answer the following questions.
13. Immediately following the supply shock, what happens to unemployment?
14. How will high unemployment in the economy affect both product prices and wages if prices and wages are completely flexible?
15. How do firms respond to a decrease in input prices?
16. What effect will firms’ response to the decrease in input prices have on SRAS?

Now, consider how Monetary and Fiscal policies interact with each other and how that influences the economy. Draw an AS/AD, a money market, and a loanable funds market diagram to illustrate the short-run effects for each policy combination. Then circle the up or down arrow (or ? for uncertain), and explain the effect of the policies on rGDP, the price level, unemployment, interest rates, and investment.

1. **Expansionary Monetary and Fiscal Policy:** The unemployment rate is 10% and the inflation rate is 2%. The federal government cuts personal income taxes and increases its spending. The Fed buys bonds on the open market.
2. Real GDP ↑ ↓ ? Explain.
3. The price level ↑ ↓ ? Explain.
4. Unemployment ↑ ↓ ? Explain.
5. Interest rates ↑ ↓ ? Explain.
6. Investment ↑ ↓ ? Explain.
7. **Contractionary Monetary and Fiscal Policy:** the unemployment rate is 6%, and the inflation is 9%. The federal government raises personal income taxes and cuts spending. The Fed sells bonds on the open market.
8. Real GDP ↑ ↓ ? Explain.
9. The price level ↑ ↓ ? Explain.
10. Unemployment ↑ ↓ ? Explain.
11. Interest rates ↑ ↓ ? Explain.
12. Investment ↑ ↓ ? Explain.
13. **Contractionary Monetary Policy and Expansionary Fiscal Policy:** The unemployment rate is 6%, and the inflation rate is 5%. The federal government cuts personal income taxes and maintains current spending. The Fed sells bonds on the open market.
14. Real GDP ↑ ↓ ? Explain.
15. The price level ↑ ↓ ? Explain.
16. Unemployment ↑ ↓ ? Explain.
17. Interest rates ↑ ↓ ? Explain.
18. Investment ↑ ↓ ? Explain.