Final Exam Review Guide for Open-ended Questions

EC 201: Principles of Macroeconomics

Fall 2021

Q1. The Fed reduced its federal funds rate target to $0.0 - 0.25\%$ in mid March, 2020. On April 29,2020, Fed chair Jerome Powell pledged to keep the rate within that range until the economy returns to full employment.

Answer the following questions:

- Why did the Fed reduce the federal funds rate in mid March? [Hint: which macroeconomic gap was it anticipating?]. Show in Graph what impact the Fed had in mind when reducing interest rates.
- Why does Powell want to keep the rates close to zero until the economy returns back to full employment? [Hint: What are the major policy goals for the Fed? How can this policy stance ensure that the Fed is contributing towards those goals?]

Q2. Last year, the government announced a fiscal stimulus package worth $\$2$ trillions dollars to fight the economic impact of COVID-19 pandemic. One of the components of the package is to provide many American families with direct cash transfers worth $\$1,200$ per adult and $\$500$ per child. A family of four (two parents and two kids) for example, gets $3,400 direct cash.

Your job is to analyze this fiscal expansion by answering the following questions:

- What type of fiscal policy is it? Which fiscal policy tool did the government use in this case? What impact is it intended to have? Show it in the graph. Provide economic reason behind why you are right.
- When the policy was implemented/passed the economy was not in recession yet–there was no recessionary gap. Does that mean the timing of this policy was wrong? If no, why not? Give your reason.
- What kind of lags did the fiscal expansion face? Provide specific examples of each of the lags. Were some lags longer than others? Why do you think so?

Q3. During the Great Depression, businesspeople in the United States were very pessimistic about the future of economic growth and reluctant to increase investment spending even when interest rates fell. How did this limit the potential for monetary policy to help alleviate the Depression?

Q4. Many economists argue that fiscal and monetary policy should work in tandem with each other rather than in isolation. Based on what you have learned about how these policies work, explain why you agree or disagree with this statement. Please give economic logic behind your argument. An argument without a sound economic logic will only get partial credit. Try to limit your answer to five to seven sentences.

Q5. The nature of the Obama era expansionary fiscal policy of 2009 and that of the Trump era expansionary fiscal policy of 2017 were similar. But many economists who supported Obama era fiscal expansion opposed the Trump era fiscal expansion. Why? Draw graphs and show the difference between the timing of these expansions.

Q6. In the AD-AS model, we learned that negative supply shocks are tricky in the sense that policymakers don't yet know what the right policy response to such shocks is (despite the U.S. economy facing such shocks back in the 1970s). Thus fiscal and monetary policies aim at influencing AD and not SRAS. In about five sentences, explain why negative supply shocks are tricky. In particular, you should talk about how the two major policy objectives of reducing unemployment (or increasing real GDP) and controlling inflation pose major challenge in handling the negative supply shocks. An answer that does not discuss these two points will not get full credit.