Tranquilla Tuesday, February 4
Willamena Wednesday, February 5

- *Learning target: I can describe problems with fiscal policy.   I can draw and explain the graph of the market for money.*
- Warm up: Who has more money--a person with $1000 cash or a person with an original Picasso painting? Talk to your neighbor.
- See Edmodo for new HW.
- Economics Quiz Bowl--any takers?

Agenda

- Warm up: What is money? (5 min)
- Work period: Review Unit 3 test; notes on problems with fiscal policy; notes on money demand market + released FRQs.
- Closing: Questions on released FRQs (10 min)

Need to take Unit 3 Test:

- Freya
- Neal
- Gray
- James (FRQ only)

5 Problems With Fiscal Policy

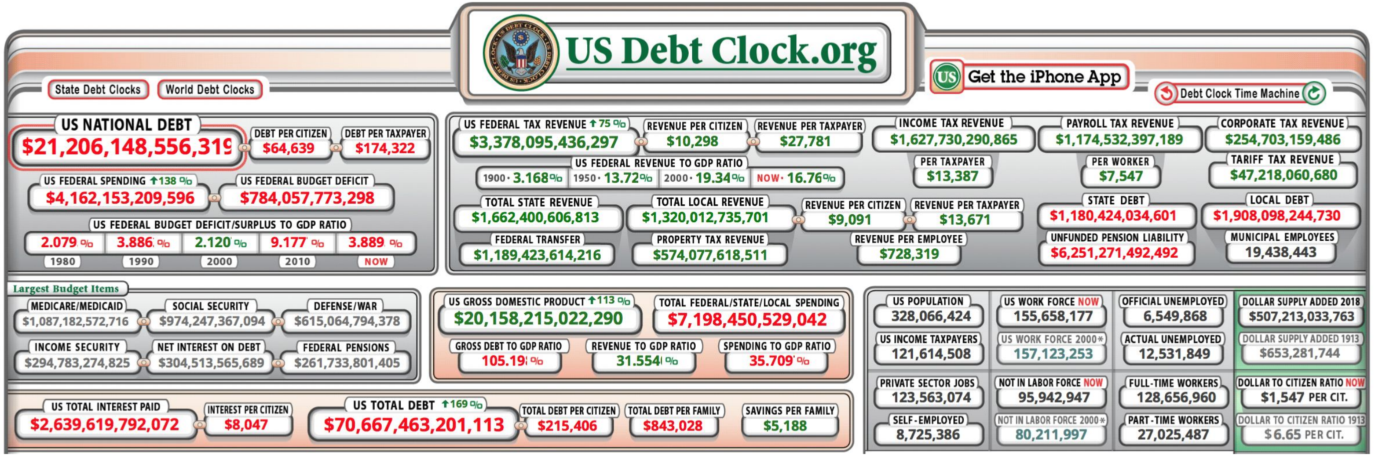
- When there is a recessionary gap, what two options does Congress have to fix it?
- What's wrong with combining both?

1. Deficit Spending!!!!

- A <u>Budget Deficit</u> is when the government's expenditures exceeds its revenue.
- The <u>National Debt</u> is the accumulation of all the budget deficits over time.
- If the Government increases spending without increasing taxes they will increase the annual deficit and the national debt.

Most economists agree that budget deficits are a necessary evil because forcing a balanced budget would not allow Congress to stimulate the economy.

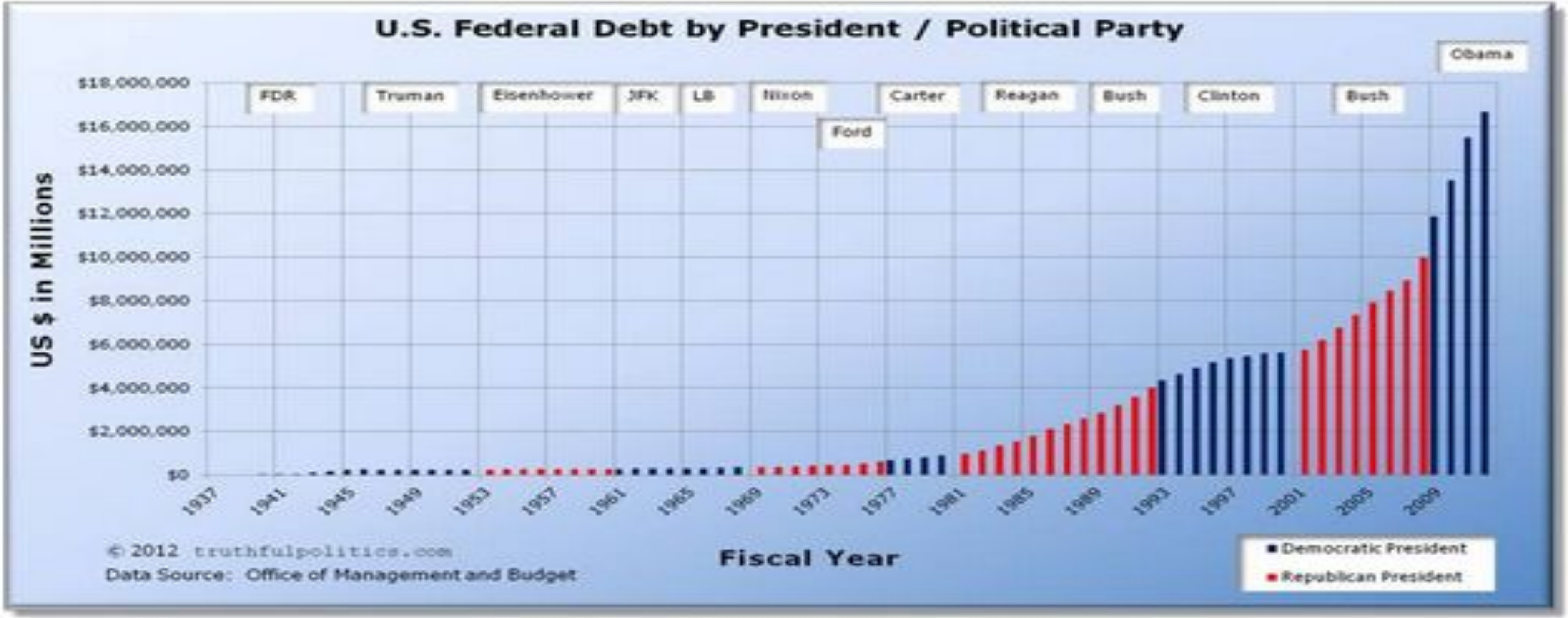
US National Debt



The Onion: Government Stages Coup

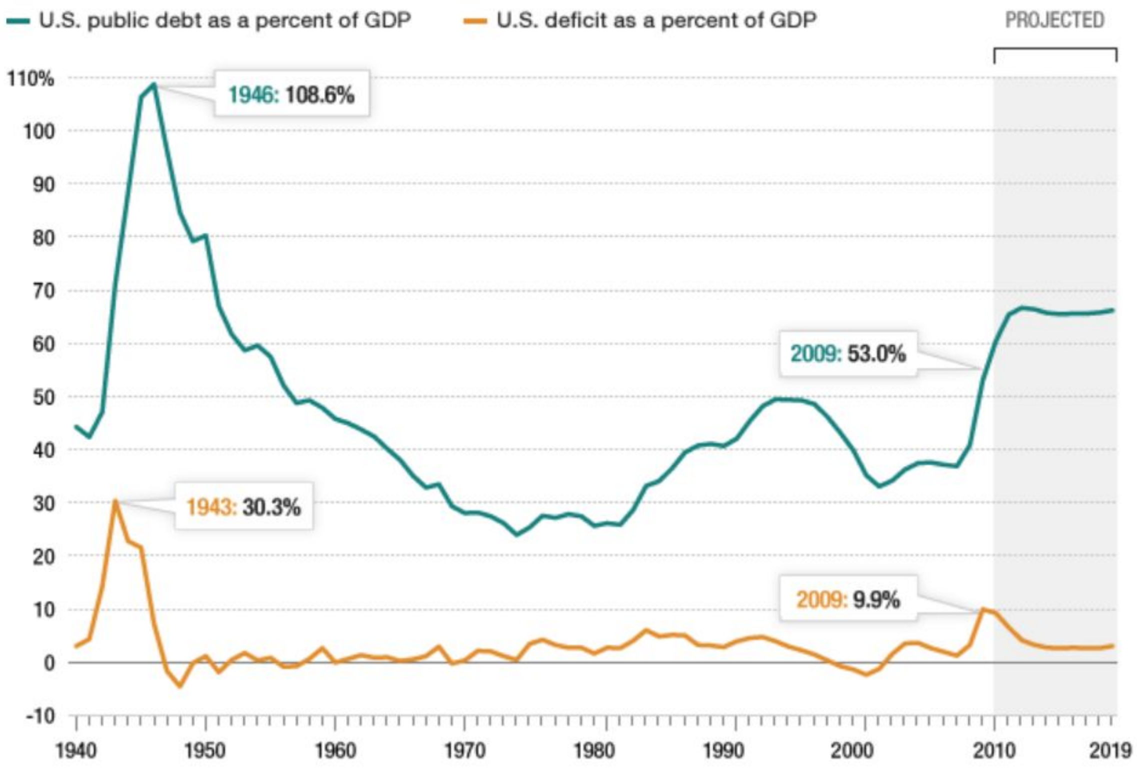
EXTENDED LEARNING

Why do you think the debt has continually increased over time?



EXTENDED LEARNING

How might the spikes in this graph be explained?



Source: Congressional Budget Office

Credit: Robert Benincasa and Alyson Hurt / NPR

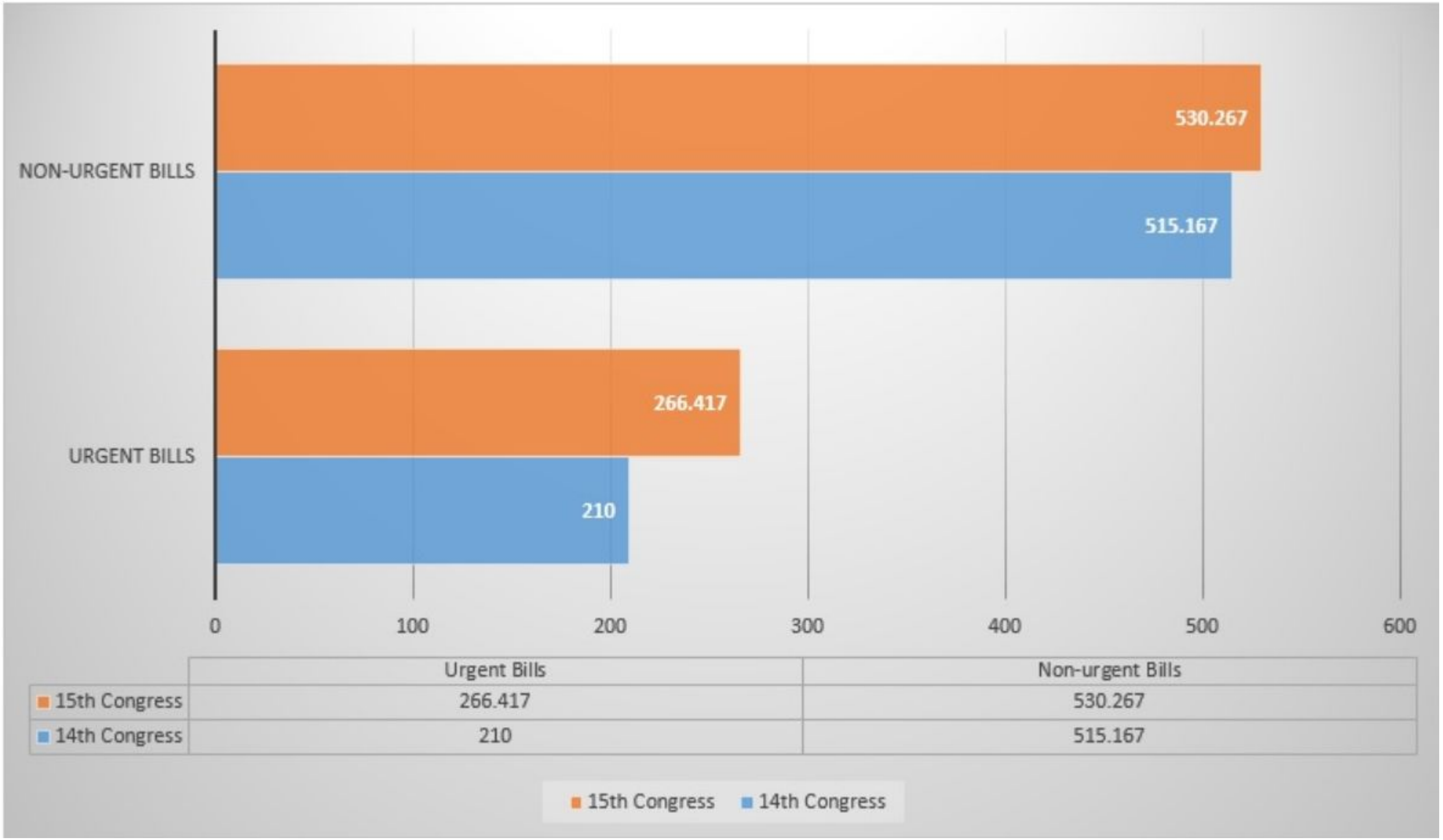
5 Problems with Fiscal Policy

2. Problems of Timing

- **Recognition Lag-** Congress must react to economic indicators before it's too late.
- **Administrative Lag-** Congress takes time to pass legislation.
- **Operational Lag-** Spending/planning takes time to organize and execute (changing taxing is quicker).

3. Politically Motivated Policies

- Politicians may use economically inappropriate policies to get reelected.
- Ex: A senator promises more welfare and public works programs when there is already an inflationary gap.



Time between the date a bill was filed and the date the bill was signed into law for both the 14th and 15th Congress.[10]

5 Problems with Fiscal Policy

4. Crowding-Out Effect

- **In basketball, what is “Boxing Out”?**
- **Government spending might cause unintended effects that weaken the impact of the policy.**

Example with a recessionary gap:

- **Government creates new public library. (AD increases)**
- **Now consumers spend less on books. (AD decreases)**

Another Example:

- **The government increases spending but must borrow the money. (AD increases)**
- **This increases the price for money (the interest rate).**
- **Interest rates rise so Investment decreases. (AD decreases)**

The government “crowds out” consumers and/or investors.

5 Problems with Fiscal Policy

5. Net Export Effect

International trade reduces the effectiveness of fiscal policies.

Example:

- **We have a recessionary gap, so the government spends to increase AD.**
- **The increase in AD causes an increase in price level and interest rates.**
- **U.S. goods are now more expensive and the US dollar appreciates…**
- **Foreign countries buy less. (Exports fall)**
- **Net Exports (Exports-Imports) falls, decreasing AD.**

1. A country's government runs a budget deficit when which of the following occurs in a given year?

   (A) The amount of new loans to developing nations exceeds the amount of loans paid off by developing nations.
   (B) Government spending exceeds tax revenues.
   (C) The debt owed to foreigners exceeds the debt owed to the country's citizens.
   (D) The amount borrowed exceeds the interest payment on the national debt.
   (E) Interest payments on the national debt exceed spending on goods and services.

2012 Audit Exam

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Unit 4: Money and Monetary Policy

Money! Who is on the

1. $100 Bill
2. $50 Bill
3. $20 Bill
4. $10 Bill
5. $5 Bill
6. $2 Bill
7. 50 Cent
8. Dime
9. $1000 Bill
10. $100,000 Bill

1. Franklin
2. Grant
3. Jackson
4. Hamilton
5. Lincoln
6. Jefferson
7. JFK
8. FDR
9. Cleveland
10. Wilson

Bonus:

"E Pluribus Unum" means….

"Out of Many, One"

Questions about money . . .

1. What is money?
2. Why do we use money?
3. What are the three functions of money?
4. What backs our money supply?
5. How do we classify or measure money?
6. What is the financial sector and what roles does it play in our economy?

Why do we use money?

What would happen if we didn't have money?

The Barter System: goods and services are traded directly. There is no money exchanged.

Problems:

1. **Before trade could occur, each trader had to have something the other wanted. ("Double coincidence of wants")**
2. **Some goods cannot be split. If 1 goat is worth five chickens, how do you exchange if you only want 1 chicken?**

What is Money?

Money is anything that is generally accepted in payment for goods and services.

Money is NOT the same as wealth or income

Wealth is the total collection of assets that store value

Income is a flow of earnings per unit of time

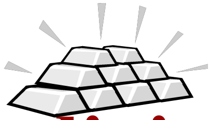
What is Money?

Commodity Money- Something that performs the function of money and has alternative uses.

- Examples: Gold, silver, cigarettes, etc.

Fiat Money- Something that serves as money but has no other important uses.

- Examples: Paper Money, Coins, digital currency



3 Functions of Money

1. **A Medium of Exchange**
    - **Money can easily be used to buy goods and services with no complications of barter system.**
2. **A Unit of Account**
    - **Money measures the value of all goods and services. Money acts as a measurement of value.**
    - **1 goat = $50 = 5 chickens OR 1 chicken = $10**
3. **A Store of Value**
    - **Money allows you to store purchasing power for the future.**
    - **Money doesn’t die or spoil.**

Weird Money

Giant stone disks were used as money on the Yap Islands. Some disks were 12ft wide.

How well would each of these items perform the three functions of money today?

1. Salt
2. Cattle
3. Gold
4. Copper coins
5. Beaver pelts
6. Personal checks
7. Savings account passbook

How well would each of these items perform the three functions of money today?

1. Prepaid phone card
2. Debit card
3. Credit card
4. Bushels of wheat
5. $1 bill
6. $100 bill

49. Which of the following is NOT a function of fiat money?

(A) A standard of deferred payment
(B) A unit of account
(C) A source of intrinsic value
(D) A store of value
(E) A medium of exchange

42. A barter economy is different from a money economy in that a barter economy

(A) encourages specialization and division of labor
(B) involves higher costs for each transaction
(C) eliminates the need for a double coincidence of wants
(D) has only a few assets that serve as a medium of exchange
(E) promotes market exchanges

What backs the money supply?

There is no gold standard. Money is just an I.O.U. from the government "for all debts, public and private."

What makes money effective?

1. **Generally Accepted - Buyers and sellers have confidence that it IS legal tender.**
2. **Scarce - Money must not be easily reproduced.**
3. **Portable and Dividable - Money must be easily transported and divided.**

What backs the money supply?

The Purchasing Power of money is the amount of goods and services an unit of money can buy.

Inflation (increases/decreases) purchasing power.
Rapid inflation (increases/decreases) acceptability.

Threefold Thursday, February 6
Fridgeville Friday, February 7

- *Learning target: I can define M1 and M2 as descriptions of the money supply and its liquidity. I can draw and explain the graph of the market for money.*
- HW 4-1 due now!
- New USATP due Wednesday, Feb. 12
- Please see Edmodo for code to switch yourself into new section of College Board

Classifying Money

Liquidity- ease with which an asset can be accessed and used as a medium of exchange.

M1 (Highest Liquidity) –

1. **Currency in circulation (AKA cash).**
2. **Checkable bank deposits (checking accounts).**
3. **Traveler's checks.**

Classifying Money

M2 ("Near-Money") - **M1 plus the following:**

1. **Savings deposits (money market accounts).**
2. **Time deposits (CDs = certificates of deposit).**
3. **Money market funds.**

Near-moneys=financial assets that aren't directly usable as a medium of exchange but can easily be converted into cash or checkable bank deposits.

Classifying Money

M1 and M2 money often earn little to no interest so the <u>opportunity cost</u> of holding liquid money is the interest you could be earning with assets like CDs, mutual funds, stocks, bonds, real estate, etc.

56. In the narrowest definition of money, M1, savings accounts are excluded because they are

(A) not a medium of exchange
(B) not insured by federal deposit insurance
(C) available from financial institutions other than banks
(D) a store of purchasing power
(E) interest-paying accounts

Order the following from most liquid (1) to least liquid (5):

- A house
- Traveler’s check
- A car
- $10 bill
- A money market share

The Financial Sector

Individuals, businesses, and governments borrow and save so they need institutions to help.

- **<u>Financial Sector</u>- Network of institutions that link borrowers and lenders. Includes banks, mutual funds, pension funds, and other financial intermediaries.**
- **<u>Assets-</u> Anything tangible or intangible that is owned.**
- **<u>Liability-</u> Anything that is owed.**
- **<u>Loan</u>- An agreement between a lender and a borrower, usually at a fee called the <u>interest rate</u>.**

A loan is an asset for the lender and a liability for the borrower.

Personal Finance and Investment

Personal finance refers to the way individuals and families budget, save, and spend.

In a personal finance class you learn about checking and savings accounts, credit cards, loans, the stock market, retirement plans, and how to manage your assets.

The word "INVESTMENT" in Econ will always refer to business spending on tools and machinery.
A low interest rate will increase investment.

The Demand for Money

At any given time, people demand a certain amount of liquid assets (money) for two different reasons:

1. **<u>Transaction Demand for Money</u>- People hold money for everyday transactions.**
2. **<u>Asset Demand for Money</u> - People hold money since it is less risky than other assets as a <u>store of value</u>.**

What is the opportunity cost of holding money in your pocket or checking account?

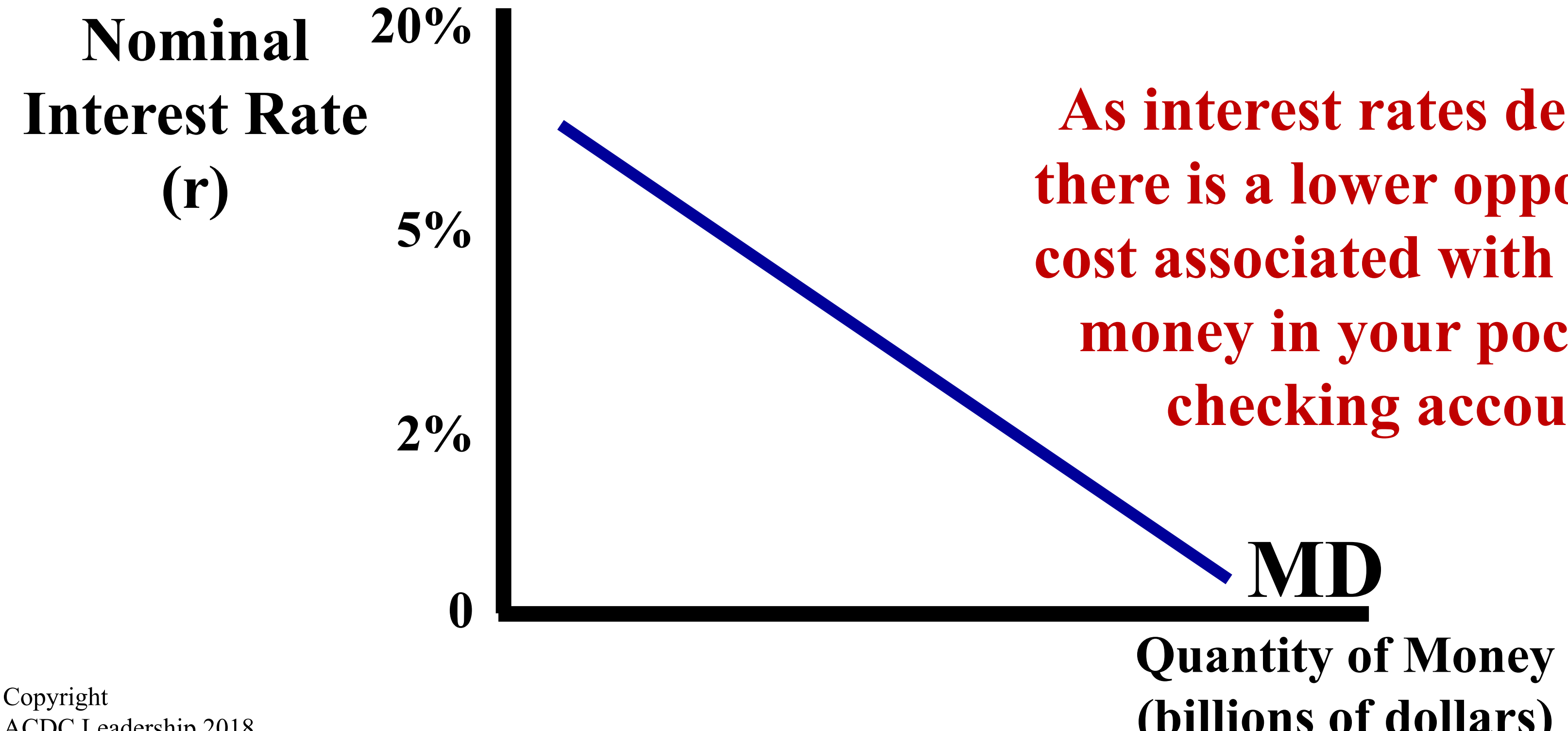
The interest you could be earning from other financial assets like stocks, bonds, and real estate.

Selected Interest Rates as of June 2007:

● One-month CD	5.30%
● Interest-bearing demand deposits	2.478%
● Currency	0

The Demand for Money

There is an inverse relationship between interest rates and the quantity of money demanded.



As interest rates decrease, there is a lower opportunity cost associated with holding money in your pocket or checking account.

The Demand for Money

1. What happens to the quantity demanded of money when interest rates increase?

Quantity demanded falls because individuals would prefer to have interest-earning assets instead.

There is a inverse relationship between the interest rate and the quantity of money demanded.

The Demand for Money

2. What happens to the quantity demanded of money when interest rates decrease?

Quantity demanded increases. There is no incentive to convert cash into interest-earning assets.

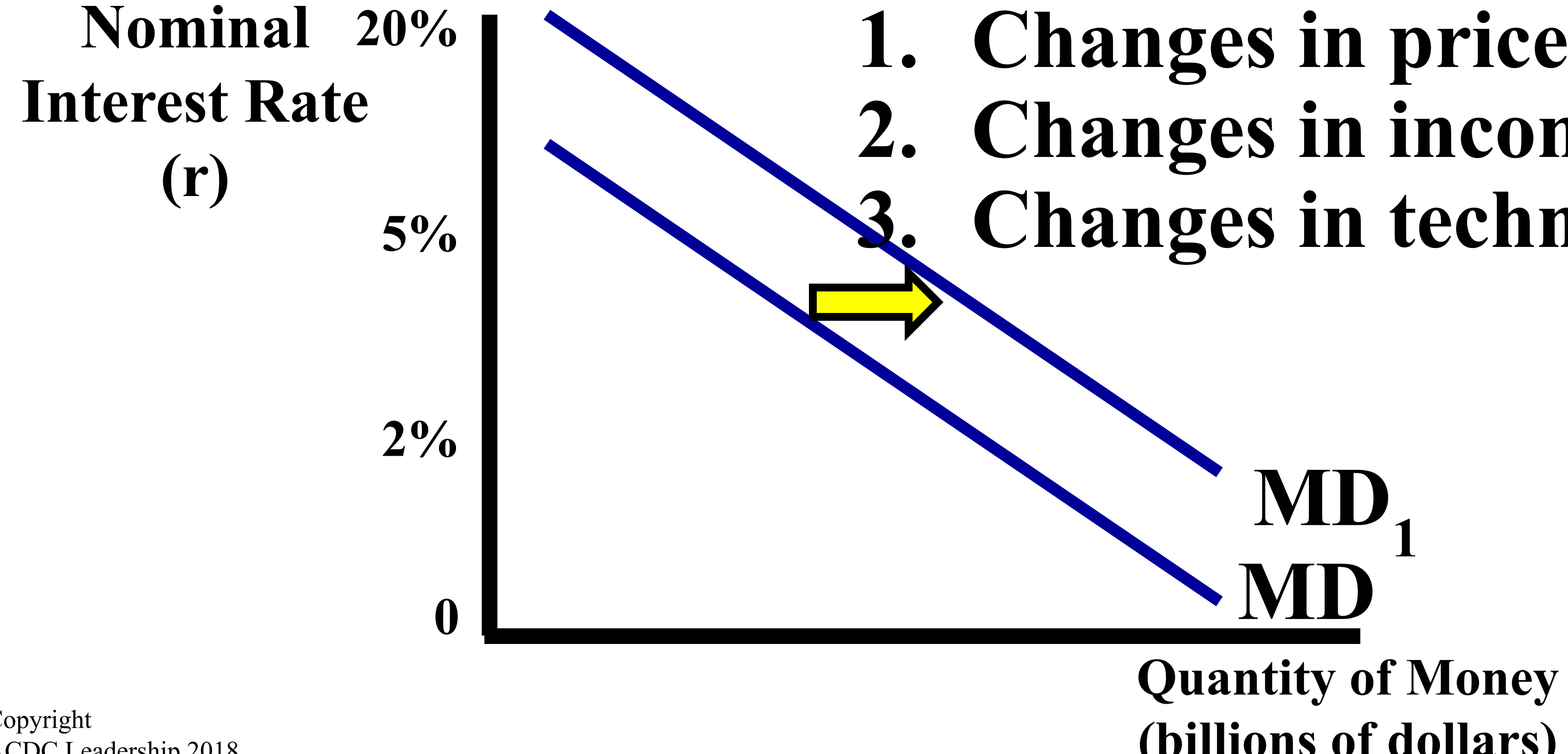
There is a inverse relationship between the interest rate and the quantity of money demanded.

The Demand for Money

What happens if price level increases?

Money Demand Shifters

1. Changes in price level
2. Changes in income
3. Changes in technology



Money Demand Shifters: Change in Price Level

- Higher prices will increase demand for money
- Lower prices reduce the demand for money
  - The demand for money is proportional to the price level, so that a 20% increase in the price level will result in a 20% increase in the quantity of money demanded at any given interest rate

Money Demand Shifters: Change in GDP

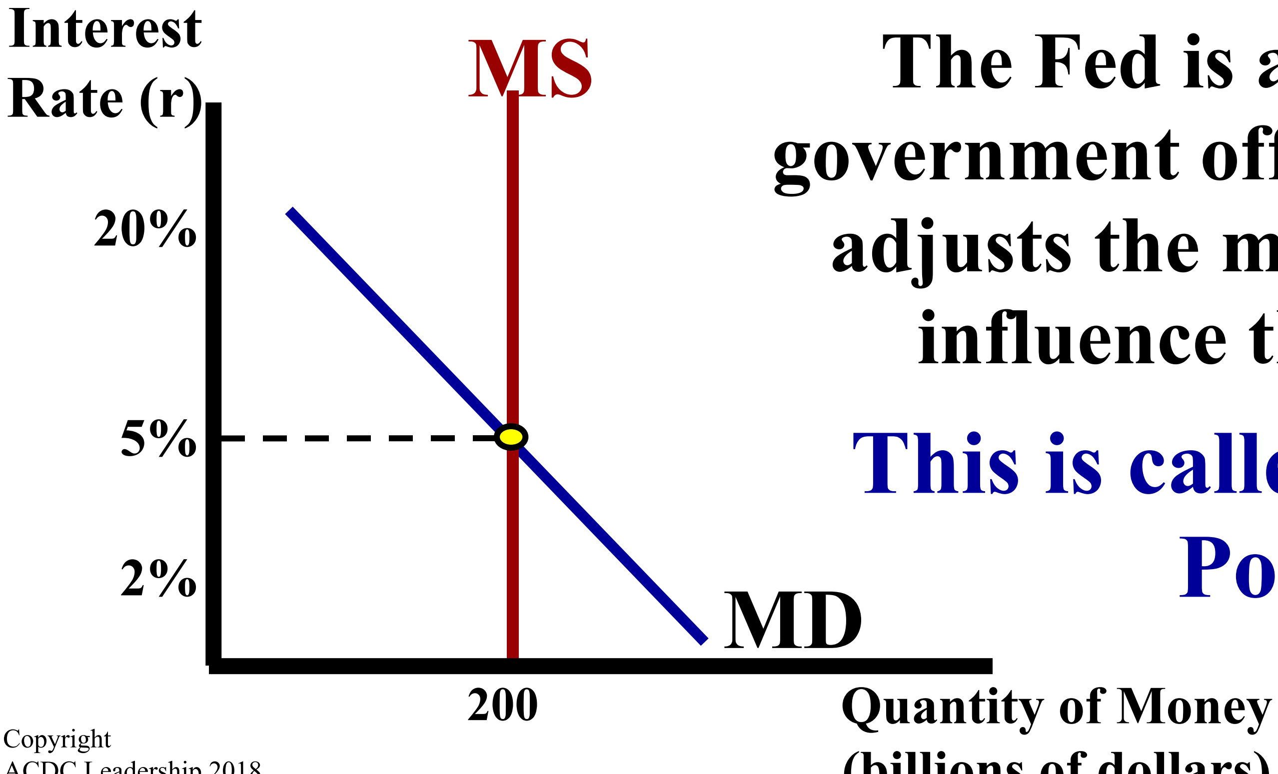
- Money facilitates purchases of goods and services, so an increase in GDP (i.e., the total quantity of goods and services produced and sold in an economy) will result in an increase in money demand.
- Also works in reverse with a decrease in GDP

Money Demand Shifters: Change in Technology or Regs

- Technology can make it easier for people to access their cash.
  - Eg, the invention of the ATM meant that people could withdraw small amounts of cash when needed without going to the bank during business hours to withdraw money from a teller (ask your parents about writing a check payable to “cash”!)

The Supply for Money

The U.S. Money Supply is set by the Board of Governors of the Federal Reserve System (The Fed).

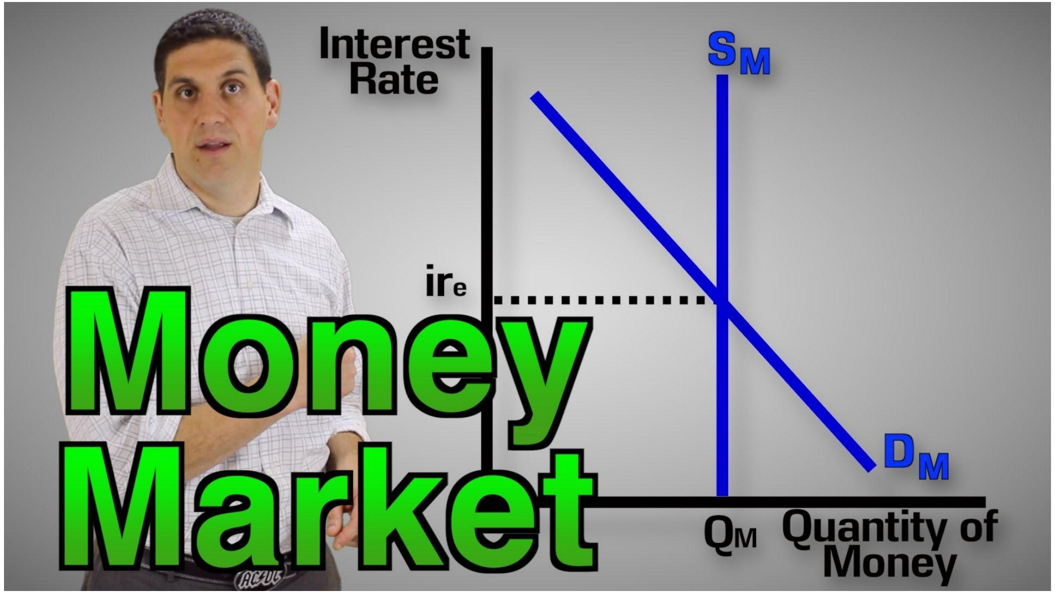


The Fed is a nonpartisan government office that sets and adjusts the money supply to influence the economy.

This is called Monetary Policy.

The Money Market

(Supply and Demand for Money)



Fun Set 4.1