Money and Banking  Answers to questions 7, 13 and 14 are given on a separate document. These questions will be on your exam and are worth a lot of points. Your job is to learn those answers word for word. If you don’t, your highest possible grade on exam 3 is a D.

1. What are the three uses of money? Give specific examples.
2. What is M1, what is M2? Explain the differences between M1 and M2.
3. What is the deposit creation formula? Why is it oversimplified?
4. Why do we need monetary control?
5. What are reserves? Where are they kept? What is the difference between excess and required reserves?
6. Explain the difference between money and income. You need to include a reference to one of the three uses of money and to the types of income noted on the Circular Flow Diagram. (This is harder than you think.)
7. Identify the three ways the Fed can control the money supply. Explain fully how each works.
8. What are the discount and federal funds rates? (Give definition, values are for extra credit.) What is the difference between them?
10. Why are Investment Expenditures (when firms purchase capital goods) inversely related to the interest rate?
11. What are the roles of the Fed? Who is the current chairman?
13. Explain and show graphically how changes in the money supply will change interest rates:
   a. use the bond market model
   b. use the Federal Funds Market
14. How does monetary policy work to close (or prevent) inflationary and recessionary gaps in the AS/AD model
15. Explain and show graphically how fiscal policy affects the interest rate and how this causes crowding out
16. Explain the differences between monetary policy and fiscal policy.

Comparative Advantage and trade.
1. Find the comparative advantage for each country given the information below.

<table>
<thead>
<tr>
<th>Output per worker per year:</th>
<th>Mexico</th>
<th>U.S.</th>
<th>Show the gains from trade for both countries by drawing their frontiers with and without trade (2 frontiers for each country).</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer Software</td>
<td>20</td>
<td>40</td>
<td></td>
</tr>
<tr>
<td>Frozen Orange Juice</td>
<td>30</td>
<td>50</td>
<td></td>
</tr>
</tbody>
</table>

2. What are the arguments in support of free trade? What are the arguments in support of protection?
3. What are the different types of barriers to trade? List and define. Within one economy, which sectors win and which sectors lose from trade barriers?

Exchange Rates, Fiscal and Monetary Policy in an Open Economy
1. Explain the difference between floating and fixed exchange rates and explain the difference between an appreciation/depreciation of a currency compared with a devaluation/revaluation of a currency.
2. Use the foreign exchange supply/demand model to illustrate fluctuations in the value of the dollar.
3. Show and briefly explain the effects of a depreciation (appreciation) of the dollar in the AS-AD graph.
4. In an open economy with floating exchange rates, show graphically and briefly explain why (a) fiscal policy is dampened (crowding out of Net Exports) and (b) monetary policy is enhanced.
5. In an open economy with fixed exchange rates, show graphically and briefly explain why (a) fiscal policy is enhanced and (b) monetary policy is ineffective.

Debt and Deficit—also see supplemental study guide questions on a separate sheet.
1. Define the terms, and give the values of current debt and deficit. Be able to read the Debt/Deficit tables.
2. List the “bogus” arguments for concern over the debt? Why are they bogus? Explain the legitimate reasons for concern?