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- The sum of the production of goods and the supply of services in a given country is defined by the country's **Gross National Product, or GNP**.

- Many factors can affect the gross national product. Here are five major ones:

  1. **Population expansion or contraction** - population growth can increase both GNP and per capita GNP.

  2. **Entrepreneurism** - all the inventions associated with computers and other technological developments, have fueled a huge expansion in the GNP.

  3. **Trade** – global trading increases GNP

  4. **War** - Wars such as World War II destroyed much of Europe's economic infrastructure and drove down the GNP of the countries involved. However, for countries like the U.S. and much of Western Europe, which today supply military arms, war can have a positive effect on the GNP.

  5. **Natural Resources** - The discovery of oil is a classic case of natural resources driving up the GNP of a region such as the Middle-East. Similarly, in rain forests around the world, harvesting trees has had a positive impact on the GNP.

- A **business cycle** is similar to the movement of a roller coaster.

- The four phases of the business cycle are **(1) expansion**, like the upward climb of the roller coaster. During the expansion phase, Gross Domestic Product, or GDP, is increasing. Usually, this also means that the rate of inflation is increasing while the unemployment rate is decreasing.

  The momentary pause at the summit is the **(2) peak**, where production reaches the highest current level. This is a time when the inflation rate is at it’s highest.

  Then comes the **(3) contraction** with decreasing economic activity, similar to the downslide of your cart. During a contraction, unemployment rises while inflation falls.

  Finally, the **(4) trough** is the lowest point of the roller coaster ride and of the business cycle. The trough is the transition from a contraction to an expansion phase and thus the worst point in a period of decline. Each full cycle of the phases typically lasts between three to five years.
Government regulation attempts to **promote growth, full employment, and price stability.**

One way the government can regulate is by setting a **price level for specific goods or services.** For example, if the government sets a minimum price for the labor market, that means setting a minimum wage. This forces business to pay workers at least the amount set by the minimum wage.

Another specific example of government regulation are **subsidies** for agriculture. They are money paid to farmers of certain commodities to supplement their income. The subsidies influence the price and quantity of those goods that make it to market and protect farmers in the event of loss from events beyond their control, like weather. Without government regulation, such events and overproduction lead to wide fluctuation in prices for agricultural products.

If the price is too high (set above equilibrium), there will be a **surplus** because businesses will produce more than consumers will demand. Conversely, a **shortage** may happen when a government sets a price for a good or service that is too low (below equilibrium), because businesses that produce the product will supply less than is demanded by consumers.

Natural monopolies are where government regulation is very beneficial. Electricity, highways, police and fire protection, legal and justice services, and U.S. currency regulation are natural monopolies. Benefits include **efficiency and fair prices** for products with a natural monopoly market.
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## The Federal Reserve

<table>
<thead>
<tr>
<th>Hierarchy</th>
<th>Section of the Federal Reserve</th>
<th>Description</th>
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</table>
| 1st       | Board of Governors             | - Analyzes economic data, supervises Federal Reserve Banks  
- Appointed by President; confirmed by Senate  
- Analyzes economic data, supervises Federal Reserve Banks  
- Administers financial regulations  
- Participates in Federal Open Market Committee  
- Communicates with leaders in other parts of government |
| 2nd       | Federal Open Market Committee (FOMC) | - Consists of Board of Governors, President of the New York Reserve Bank, and four other Reserve Bank Presidents on a rotating basis  
- **Discusses economic outlook and potential adjustments to the money supply**  
- Gathers for eight meetings per year in Washington, D.C. |
| 3rd       | Federal Reserve Banks          | - Comprised of 12 Federal Reserve Banks, each serving its own region of the United States  
- **Provides service to banks and the U.S. Treasury—“the bankers’ bank”**  
- Supervises bank operations within their region  
- Handles check collection, electronic funds transfer, distribution of currency and coin to banks  
- Provide service as banks for U.S. Treasury accounts—issue and redemption of U.S. government securities |
| 4th       | Member Banks                   | - Consists of 38% of commercial banks (like Bank of America®)  
- Are stockholders in regional Federal Reserve Bank, receive dividends  
- **Receive services from regional Federal Reserve Bank** |
| Other     |                                 | - Not technically not part of the Federal Reserve System, |
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<tr>
<th>5th</th>
<th>Depository Institutions</th>
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<tr>
<td></td>
<td>yet subject to regulations</td>
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<tr>
<td></td>
<td>Receive services from regional Federal Reserve Bank</td>
</tr>
<tr>
<td></td>
<td>Includes credit unions, savings and loan associations, commercial banks, and savings banks</td>
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**Monetary Policy**

- **Expansionary monetary policy** includes actions of the Fed that expand, or increase the money supply. Economists associate increasing the money supply with quickening the pace of economic growth and fighting recession.

- **Contractionary monetary policy** includes actions of the Fed that contract, or decrease the money supply. Economists associate decreasing the money supply with slowing down economic growth and fighting inflation.

- The Federal Reserve has three tools of monetary policy to affect the money supply:

  1. **Discount Rate**—the interest rate the Federal Reserve charges banks to borrow currency.
     
        Decreasing DR= member banks borrow more $$= banks loan more $$ to people
        
        Increasing DR= member banks borrow less $$= less loans available to people

  2. **Reserve Requirement**—the percentage of a bank’s deposits that must be kept as currency and coin in the bank.
     
        Decreasing RR= banks keep less $$ in vault= banks loan more $$ to people
        
        Increasing RR= banks keep more $$ in vault= less loans available to people

  3. **Open Market Operations**—the Federal Reserve’s frequent buying and selling of government securities (bonds), considered the most significant of the three tools.
     
        Buy bonds= FED gives banks $$ for bonds= banks loan more $$ to people
        
        Sell bonds= FED gets $$ from banks= less loans available to people by bank
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- The more money banks have to lend, the more businesses may open and expand. People will purchase more homes and automobiles. Expanding businesses lead to additional job openings and people with jobs make purchases.

**Fiscal Policy**

- The tools of fiscal policy are taxing and spending.
- Our government creates a **deficit** by spending more than the total tax revenue and **debt** is the total amount government owes. Government can create a **surplus** by collecting more in taxes than is spent on programs.
- The government borrows money by selling bonds and other investments to individual people and companies with money to invest.