**Answer three of the following:**

1. Why did the FOMC under Paul Volcker in the late 1970’s to early 1980’s shift from targeting the fed funds rate ( i ) to targeting the quantity of money (M)?What were the results?

2. Explain how increases in the money supply first change real income and then the price level, using Friedman’s portfolio concept of money as an asset held in the form of real money balances, M/P.

3. To explain the surprising events of 1970 to 1975, Milton Friedman distinguishes between short-run spending effects and long-run price level effects of central bank changes in the money supply. He calls this the “Modern” Quantity Theory of Money in contrast to the Classical Quantity Theory of Money. Translate these two MQT propositions into orthodox parameter shifts of the LM curve.

4. Use the AD/AS model to illustrate the Classical proposition that fiscal policy only creates **inflation** that “crowds out” private spending. Now contrast this version by showing on the IS/LM diagram the Classical position that government deficit spending will just raise **interest rates** and in this manner “crowd out” private sector spending.

5. Draw the four-graph derivation of Hick’s LM curve and show how increases in the public’s demand for money can offset a Fed policy of monetary ease.

6. In the IS/LM model, draw an LM curve that illustrates Mr. Keynes’ special case of a completely elastic demand for money, i.e., the “liquidity trap.” Under these conditions, will monetary or fiscal policy work better to increase GDP? Illustrate these policies on your graph.