**Aim: What are the problems of fiscal and monetary policy?**

**Topic: Monetarizing Debt and Rational Expectations**

**Motivation: Look at cartoons – what problems do cartoons show?**

**Problem #1: Monetizing Debt:** There are two ways a government can finance a deficit. One is by borrowing, the other is by asking the treasury and FED to print more money, or effectively buying some of the government debt. This is called "monetizing of the deficit" and leads to inflation or sometimes even to hyper inflation. Instead of borrowing money, governments print money to fund their spending. The problem with this is that it decreases the value of the dollar and raises inflation (the price level and the consumer price index). The Fed contributes to debt monetization as well: when it buys bonds (through open market operations) it may print the money to do so or treat the bonds as a credit – in which case, the Treasury Department is credited, but must still pay back the Fed one day.

**1) What is monetizing the debt/deficit?**

**2) What is the process for monetizing the debt/deficit?**

**3) How can monetizing the debt lead to inflation?**

**4) Why would a government still risk this?**

**5) How is inflation and unemployment trade-offs and opportunity costs of each other?**

**Problem #2: Rational Expectations:**

This hypothesis was created by Robert Lucas. It is based on the idea, that households and businesses will use all the information available to them when making economic decisions. People and businesses understand that when a government deficit spends, this causes an increase in prices. Households will supply less labor unless wages are matched, and businesses will supply less products if the cost of labor and manufacturing rises (in the long run, AS shifts to the left). This reduction in output nullifies the expansionary effect of fiscal policy.

In accordance with Classical Theory, the rational expectations theory assumes that wages, prices, and interest rates adjust quickly to keep real GDP at the full-employment level. Unemployment is seen as a temporary result of random shocks, because on the average, wages and prices are set at the levels that equate supply and demand in both the product and labor markets. The bottom line of the rational expectations theory is that government intervention is not necessary or useful for stabilizing the economy.

When all of the shifts are done, output has not changed, but prices have overall increased.

**1) What is the theory of rational expectations?**

**2) How is the theory of rational expectations a criticism of Keynesian Fiscal Policy?**

**3) Draw a) expansionary fiscal policy b) the results of the policy according to rational expectations.**

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| **Aim:** | **Date:** |
| **Objective Questions** | **Key words** |
|  | 1.2. |

**Credit**

**A. Credit Reports**

Credit is the ability to obtain goods or services before payment, based on the trust that payment will be made in the future. Credit history or credit report is a record of an individual's or company's past borrowing and repaying, including information about late payments and bankruptcy. When a customer fills out an application for credit from a bank, store or credit card company, their information is forwarded to a credit bureau. The credit bureau matches the name, address and other identifying information on the credit applicant with information retained by the bureau in its files. This information is used by lenders such as credit card companies to determine an individual's credit worthiness; that is, determining an individual's willingness to repay a debt. The willingness to repay a debt is indicated by how timely past payments have been made to other lenders. Lenders like to see consumer debt obligations paid on a monthly basis. The other factor in determining whether a lender will provide a consumer credit or a loan is dependent on income. The higher the income the more credit the consumer can access. A person can check their credit report for free through three Credit Reporting Agencies: Equifax, Transunion and Experian.

*How would you describe credit reports?*

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**B. Credit Score**

Your credit score is a number that predicts how credit-worthy you are. It is based on information in your credit report such as your bill-paying history, the number and type of accounts you have, late payments, collection actions, outstanding debt, and the age of your accounts. A statistical program compares your information with consumers who have similar profiles, and determines a total number of points. Your credit score guides companies and banks in their decision whether or not they will do business with you and on what terms. Credit score numbers range from about 350 (low) to 800-850 (high). Your credit score affects:

* Whether you qualify for a mortgage, and how much money you can borrow
* Whether a landlord should trust you to pay your rent on time each month
* What kind of limit you should have on your credit card
* What sort of interest rate will be available to you
* Whether you qualify for an increased credit line
* What insurance and insurance rates you qualify for

Credit scores above 700 are very good and a sign of good financial health. Scores below 600 indicate high risk to lenders and could lead lenders to charge you much higher rates or turn down your credit application.

*How would you describe credit scores?*

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**C. Rebuilding Credit**

“If you have too much debt, you might be able to benefit from consolidating your debts. Instead of making multiple payments each month, you’ll make only one. Debt consolidation won't immediately improve your credit score. But it can help you effectively manage and reduce your debt over time… A debt consolidation loan can give you: A lower monthly payment than your current payments. This allows you to …the simplicity of one bill to track…. Keep in mind: It's important to understand that a debt consolidation loan simply transfers the debt to a new lender, so you still have debt. Additionally, a consolidation loan with a longer repayment period may lower your monthly payment, but increase the total amount you repay. However, you can always pay off the loan faster by making more than the minimum monthly payment.

*- Wells Fargo*

*How can you rebuild your credit?*

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**Credit Cards**

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**A. Credit Cards**

A credit card is a small plastic card issued to users as a system of payment. It allows its holder to buy goods and services based on the holder's promise to pay for these goods and services. The issuer of the card creates a revolving account and grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a merchant or as a cash advance to the user. Credit card issuers usually waive interest charges if the balance is paid in full each month, but typically will charge full interest on the entire outstanding balance from the date of each purchase if the total balance is not paid. For example, if a user had a $1,000 transaction and repaid it in full within this grace period, there would be no interest charged. If, however, even $1.00 of the total amount remained unpaid, interest would be charged on the $1,000 from the date of purchase until the payment is received.

*How would you describe a credit card?*

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**B. Teens and Credit Cards**

 “It's no secret that many college students are quickly sucked deep into credit card debt. But now it seems the problem can start even before freshman year … nearly a third of high school seniors reported having a credit card of their own or one co-signed by a parent…Because young people under 18 technically can't apply for a credit card without a parent's co-signature, it's hard to know precisely how many teens have credit and how many are already in debt. But according to surveys conducted by Robert Manning, author of "Credit Card Nation: The Consequences of America's Addiction to Credit," the number of incoming college freshmen with credit cards tripled between 1999 and 2002...I was shocked to learn that kids not yet old enough to drive are receiving card solicitations -- co-addressed to parents -- while they are still living at home. Janet Bodnar, author of "Raising Money Smart Kids: What They Need to Know about Money and How to Tell Them," is appalled that her 16-year-old son regularly gets credit card solicitations -- even if they include her name on the address… "Most kids can't hand in a paper on time, let alone pay a bill on time," she says. "This is funny money to them. It's not real. It's a license to spend, and they're not learning how to manage money on their own.’…many of the cards have hidden fees, and they may compromise teenagers' privacy, says Manning, a professor of finance at Rochester Institute of Technology. "They're very scary. (Credit companies) are getting all this personal information about your child and putting it into a database, the better to market to them when they turn 18."How to help teens protect themselves: Boost their financial IQ, set limits and demonstrate the debt trap.”

- *MSN Money*

*How would you describe the relationship between teens and credit cards?*

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