

This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will be at 7:00 on Thursday, October 15<sup>th</sup>.

Chapter 8: What do we mean by **product markets** and **factor markets**? Know what is calculated in **GDP** and what is not. That method is the **expenditure method (C+I+G+X)**. Remember that “X” can be negative and that *you are likely to get the definition of “I” wrong. Stocks and bonds are not investment.* Ignore inventory investment. It is very small and confusing. Why should GDP calculated this way equal the **sum of the incomes and the sum of the value added**? What are some problems with trying to calculate GDP? What are some of the limitations in our understanding the meaning of different levels? How do we calculate GDI, NDP, NI, PI, and DPI? What is the difference between **real** and **nominal GDP**? Ignore the chain-weighted measure for real GDP. How do we compare GDP across countries?

Chapter 9: What is **economic growth**? What are the negative effects of economic growth? What is the problem of using this as a measure of welfare? What causes GDP per capita to grow? Why do small changes in the growth of GDP matter? Why should you start saving for retirement now? What is **labor productivity** and what changes it? Why is **saving** so important to growth? What is **human capital**? What are the advantages and disadvantages of **patents**? Why do open economies grow faster? How does population growth affect development? Why are property rights important for growth? The **four keys to development** on Page 215 will help you to understand parts of the chapter. *A good webpage with advice on how to save is [https://getpocket.com/explore/item/the-best-advice-for-saving-as-much-as-you-can?utm\\_source=pocket-newtab](https://getpocket.com/explore/item/the-best-advice-for-saving-as-much-as-you-can?utm_source=pocket-newtab).*

Chapter 12: Note we will not be making the Assumption #4 on Page 265. We will assume an open economy. What are C, I, G, and X? What determines them? Know what moves the flatter line on the **45° diagram, a.k.a. the Keynesian Cross diagram**. *We only need the  $E = Y$  line and  $C + I + G + X$  line and to move it. The other lines, like the C and the C + I lines were just to help you understand the main line. Ignore the savings line and the  $S = I$  derivation of the model. It is mathematically the same as what we did and the book does, but it is more complicated to understand.* What are the **MPC, MPS, APC, and APS**? *Note that even though our model assumes the MPC is the same for rich and poor, it also concludes that the rich will have a lower APC than the poor. It is easier to notice a person’s APC than MPC.* Know what changes C, I, G, and X. Why does consumption depend upon wealth, although not much? Why does investment depend upon interest rates? Ignore the planned versus unplanned investment. What is a lump-sum tax and how does it affect the 45° diagram? What determines net exports? *Note that the AD line is virtually the same as the C + I + G + X line.* Both represent how much is being demanded. However, changes in the price level will move the C+I+G+X line but not AD line. What determines the size of the **government spending multiplier**? What is the economics behind it? How do we see it on the Keynesian Cross diagram? How do our assumptions about prices, interest rates, income taxes, and imports affect its size?

Chapter 10: Even though we will have covered much of this chapter, it will not be on the exam because you really need all of this chapter and Chapter 11 to understand this.

Note that last semester, all of this material was on Exam #2.

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Non-graded Homework Assignment #6A to be reviewed with Assignment #6.

- 1) (25 points) Draw the Keynesian Cross diagram, a.k.a. the  $45^\circ$  diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. Given your diagram, how much is the government spending multiplier? Show all work and briefly explain how you did your calculation.
- 2) (10 points) When we calculated the government spending multiplier in class, we implicitly made a lot of assumptions. What did we assume about net exports? If we relax that assumption (no longer make that assumption), then what will happen to the size of the government spending multiplier? Explain your logic.
- 3) (15 points) Suppose the consumption function is given by  $C = 300 + .8(Y-T)$ . If a person's income is \$10,000.00, then how much is that person's MPC, MPS, APC, and APS? Show all work. If there is no work, then briefly explain what you did.
- 4) (10 points) If the MPC is .8, then how much is the government spending multiplier? Show all work. If the government wants to have the GDP increase by \$1000, then how much would they have to spend? Explain your logic.
- 5) (20 points) Draw the Keynesian Cross diagram, a.k.a. the  $45^\circ$  diagram. Illustrate the effects of a decrease in the Canadian GDP. What happens to GDP? Explain why the curve(s) moved as drawn.
- 6) (20 points) Draw the Keynesian Cross diagram, a.k.a. the  $45^\circ$  diagram. Illustrate the effects of an increase in the interest rates. What happens to GDP? Explain why the curve(s) moved as drawn.