

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 a time to be determined in class, probably Thursday, 10/27.

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** will help you to understand parts of the chapter.

Chapter 12: Note we will not be making the Assumption #4, that the economy is closed. 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? 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: What is meant by the term **long-run aggregate supply curve**? What determines its shape and its location? How does it relate to the PPF, a.k.a. the PPC? What is **aggregate demand**? Why does it take its shape? Note the logic used for the demand curve's slope does not apply to the slope of the

aggregate demand curve. What moves the AD curve? *Anything that changes the demand for goods and/or services ($C+I+G+X$), other than price induced changes in the demand, will move AD. Remember that for all curves, if a variable on one axis changes causing the other variable to change, then you did not move the curve, you retraced it.* What causes inflation? What are **demand pull and cost push inflation**? The book goes into more detail in Chapter 11.

Chapter 11: Draw only the “modern SRAS” Curve. For this **exam only**, when it comes to moving the SRAS Curve, say, “It moves the same way as the LRAS.” After this exam, I will not accept that explanation. *The equilibrium is where SRAS and AD cross. If that point is to the right of the LRAS, then the unemployment rate is too low because GDP is above Y_{FE} , so we are producing too much. If that point is to the left of the LRAS, then the unemployment rate is high because GDP is down. Unless I tell you otherwise, start with all three curves crossing at one point.*

Non-graded Homework #7A to be reviewed Homework #7

- 1) (20 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in government spending. Explain why the curve(s) moved as drawn. What happens to the price level, GDP, and the unemployment rate? Briefly explain how you determined what happened to unemployment rate.
- 2) (20 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in interest rates. Explain why the curve(s) moved as drawn. What happens to the price level, GDP, and the unemployment rate? Briefly explain how you determined what happened to unemployment rate.
- 3) (20 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of an increase in population. Explain why the curve(s) moved as drawn. What happens to the price level, GDP, and the unemployment rate? Briefly explain how you determined what happened to unemployment rate.
- 4) (20 points) Draw the SRAS/LRAS/AD diagram. Illustrate the effects of a decrease in the amount of capital caused by a war. Explain why the curve(s) moved as drawn. What happens to the price level, GDP, and the unemployment rate? Briefly explain how you determined what happened to unemployment rate.
- 5) (10 points) What is wrong with this statement, “When prices go up, people cannot afford to buy as much, that is why the AD curve slopes down.”?
- 6) (10 points) Why does the AD curve slope down?