

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.

The review session will probably be Tues., 4/9, at a time to be determined, in the normal room (I hope). You will be given a pair of equations and asked to explain one of them. The equations at the end of the chapters will help you prepare for this part of the exam.

Chapter 6: What causes economic growth? How do we measure  $A$ ? Be able to calculate the growth of **total factor productivity**. What is the **Solow Growth Model**. Be able to draw the **per-worker production function**. Understand what moves it. How do we find  $k_G$  (the “golden rule” capital-labor ratio),  $k_{max}$  (the maximum capital-labor ratio), and  $k^*$  (the equilibrium capital-labor ratio)? Why is the latter at the point where  $sf(k)$  crosses  $(n+d)k$ ? What moves those two lines? Why does the economy automatically move towards  $k^*$  and why is that not necessarily at  $k_G$ ? Understand the economic reasons for the changes in  $k$  that the diagram predicts. For **endogenous growth theory**, understand why they assume  $Y=AK$  and why  $\Delta Y/Y = sA - d$ . What government policies affect “s,” “A,” and “d”? (Nothing the government does really affects d.) Why do they have those effects? (They can be seen on pages 240 - 242.) For this chapter, it is crucial that you remember the differences between small and CAPITAL letters. Remember that small letters are rates, ratios, or fractions. Do NOT use them interchangeably with capital letters.

Chapter 7: What are the three functions of money? What are in **M1** and **M2**? Why do we have more than one definition of money? How does the central bank affect the money supply? What determines which type of assets you want? (**Expected return, risk, and liquidity**) What determines the demand for money? (**Price level, real income, interest rates, wealth, and the properties of other assets.**) The summary on **Page 255** should be a big help. What is the **quantity theory of money**? Why should the **velocity of money** be constant? Why hasn't M1's velocity been constant? Why is the inflation rate dependent upon the growth of money and the growth of GDP?

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

- 1) (20 points) Explain  $M^d = L(P, Y, r, \pi^e, i^m)$ .
- 2) (10 points) How does increasing the discount rate affect the money supply? Explain the process.
- 3) (20 points) The velocity of money for M1 ( $V1$ ) has become unstable. Why? What do you think explains the major dip in the velocity of money in 2009? Explain why that event would change  $V1$  but not  $V2$ .
- 4) (20 points) Write the equation for the Quantity Theory of Money. Why does it matter if  $V$  is constant? Explain how one implication of the theory would be different if the velocity was unstable.
- 5) (10 points) Explain  $\pi = \Delta M/M - \eta_Y \cdot \Delta Y/Y$ . You can treat  $\Delta$ variable/variable as one variable.
- 6) (10 points) Does M1 or M2 do a better job as a store of value? Explain your logic.
- 7) (10 points) Does M1 or M2 do a better job as a medium of exchange? Explain your logic.