

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may have inadvertently overlooked something. 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 on the homework assignments, and possibly a few definition questions. I am more likely to ask questions that make you use definitions rather than have you recite them. I may take a question from the book.

I will hold the optional review session for this test will be on **Monday 10/27 at 8:45 in 107 Old Main.**

Chapter 8: What is the simple circular flow? 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 investments. Ignore inventory investment. It is very small and confusing. Why should the 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? Ignore GDI because they state it is the same as GDP, just calculated differently. Know how to get from GDP to NDP, NI, PI, and DPI. Note that if you know what those terms are trying to measure, you ought to be able to figure out what is added and what is subtracted. Capital consumption allowance is another way to calculate depreciation. 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? What is labor productivity and what changes it? Why is saving so important to growth? What are the advantages and disadvantages of patents? Why do open economies grow faster? How does population growth affect development? The four keys to development on pages 212 and 213 will help you to understand parts of the chapter.

Chapter 10: What is meant by the term aggregate supply curve? What determines its shape and its location in the long-run? 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? 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: What are the assumptions of the classical school? What did Say say? How does it relate to the SRAS curve? Note that we went into more detail than the book on that explanation. Why should $S = I$? What assumptions did Keynes make? How did that relate to the SRAS curve? Why do we draw the “Modern” SRAS? What moves the SRAS? Notice that the only thing that moves SRAS

without moving LRAS is the price of inputs because they do not affect how much could be produced if we are at full employment. Note the book has a useful table on page 255, which is slightly misleading in the next to last line. Marginal **business and/or sales** tax rates move the SRAS because it is a cost of production, while marginal **income** tax rates affect aggregate demand because they reduce income, not raising the cost of production. The prices of inputs only temporarily affect the costs of production without any long-term effects. Since expected future price increases will increase wages, which are an input price, it will move only the SRAS curve. What are inflationary and recessionary gaps? How will they solve themselves if the government takes no actions? What are the demand pull and cost push inflations? How does a change in the value of the dollar on the foreign exchange market affect the SRAS/LRAS/AD diagram? Note that the book should combine the panels in figure 11-17.

Chapter 12: Note we will not be making the assumption #4 on page 267. 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 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? Understand what the multiplier, a.k.a. the autonomous expenditure multiplier, a.k.a. the government spending multiplier, is and the process that causes it to be greater than 1. Do not worry about the specific formula because it will change when investment, taxes, and/or imports become functions of income. Know how to derive the AD curve from the 45° diagram, a.k.a. the Keynesian cross diagram. Why do price changes effect the multiplier?

Non-graded assignment #6A to be covered with assignment #6.

1) (20 points each) Illustrate each of the following events on separate 45° diagram, a.k.a. Keynesian cross diagram. Explain each movement.

- A) The government rebuilds Route 2.
- B) The marginal propensity to save increases.
- C) Interest rates increase.
- D) The Canadian GDP increases.

2A) (10 points) Suppose the MPC is 0.8. If the government increases its spending by \$1000, then how much will the ultimate change in GDP be? Explain your logic. How could the answer be greater than 1?

2B) (10 points) Your answer to Part A assumes that prices are constant. How would relaxing that assumption affect the size of the multiplier? Explain your logic.