

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 Tuesday, 9/21, at 7:00, in the normal room.

Chapter 11: What are the three reasons people hold money? How do they relate to the demand for liquidity in the Keynesian model? Ignore figure 11-1. What is the asset demand for money? Which category of money are we talking about when we talk about the demand for money? Why did we draw the total demand for money asymptotic to both of the axes? What does it mean that the demand for money function is for real balances and there is no money illusion? What is the money multiplier? Why is it greater than 1?

Understand why  $km' = (1+cr)/(tr+cr)$ . Explain why  $M/M^* = f(r - r_d)$  and how that relates to the shape of the  $M_D$  curve. What is meant by the quantity theory of money? Be able to explain each of the steps in figure 11-5. Why does Friedman say  $M_D = f(Y_p, w, r_b, r_e, p, \Delta p, u)$ ? Note that  $w$  is not what you would first expect it to be. Why do  $p$  and  $\Delta p$  have opposite effects upon  $M_D$ ? How does that relate to  $V$ ? Why is it important to know if  $V$  is constant, predictable, or unpredictable? Why has  $V_1$  grown over time and become unstable, but  $V_2$  has only changed slightly?

Chapter 13 until page 537: What determines the growth of real GDP over time? What is  $K/N$  and why is it important? How can  $Y/P$  grow without  $K/N$  growing? What is considered full employment now? How do you use it to estimate potential GDP? How else could it be calculated? Why did the growth of potential GDP drop during the late 1970's? Why didn't go back up during the 1980's when the situation reversed itself? What does this say about the future given what George W. Bush has done? Why does it take a long time for the deficit and debt to affect interest rates? Why does it matter if growth has dropped by  $\frac{1}{2}$  of 1%? Understand how the Harrod-Domar model of growth works.

Laboratories: Be able to take a system of equations and find the short-run government spending multiplier. (Solve  $Y = C + I + G + X - M$  for  $Y$  with only lagged variables and exogenous variables like  $G$  on the right-hand side. The number in front of  $G$  is it.) Be able to put the formula into a spreadsheet to find the path of GDP over time. Use the spreadsheet to find what happens with a temporary and permanent change in  $G$ . Use those to find the long-run government spending multiplier. Know how to plot the paths. Know how to tell if the path is monotonically converging, has monotonic explosion, oscillating convergence, or oscillating explosion. Make sure you label graphs.

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This is the non-graded assignment #2A that will be gone over with assignment #2.

- 1) (30 points) Explain the two methods used for calculating potential GDP. Explain which you would use if your goal was accuracy. Explain your reason for thinking that method is more accurate. (Both could be argued to be more accurate.)
- 2) (25 points) We discussed two reasons why the growth rate of real GDP dropped. One for the late 1970's and one for the 1980's and 1990's. For one of them, state the cause we hypothesized. How do you think we might be able to test it?
- 3) (15 points) Use a spreadsheet to show a 2.5% growth of GDP over a 30 year period. Start with  $GDP = 100$ . Repeat this for a growth rate of 2.0%.
- 4) (15 points) Why is it important if the technology is neutral, capital deepening, or capital saving?
- 5) (15 points) Why does it take a long time for deficits to raise interest rates?