Wilfrid W. Csaplar Jr. Principles of Macroeconomics Review Sheet for Exam 3

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 11/3.
See your advisor this week so that you can register for classes.

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.

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 which will be on the next test.

Chapter 11: We will not have covered enough of Chapter 11 to put it on the test. However, putting the **SRAS Curve** on the graph makes the results which are more realistic. Therefore, for the SRAS Curve **on this test only**, draw it as an upward sloping line which moves the same direction as the LRAS movement. The equilibrium is where AD crosses SRAS. (Starting the homework after the exam, you will have to draw the correct shape SRAS and give a more detailed explanation of why it moves.)

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 does our assumptions about prices, interest rates, income taxes, and imports affect its size?

This is the non-graded Assignment #7A that will be reviewed with Assignment #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 and real GDP?

2) (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 and real GDP?

3) (15 points each) For each of the following, tell me what we assumed about that variable when we calculated the government spending multiplier. If we relaxed that assumption, what would happen to the size of the multiplier? Why would that happen?
A) interest rates
B) net exports

4) (15 points) Why does the AD Curve slope down?

5) (15 points) What is wrong with answering Question #4 with "When the price level goes up, it means that on average prices are higher; therefore, people cannot afford to buy as much."?