

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may have 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 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 workbook.

The review session for this test will be held Thursday 4/10 at 7:00 P.M. in the normal room, Richardson 201.

Chapter 10: What is meant by aggregate supply? What determines its shape and its location in the long-run? How does it relate to the PPC, a.k.a. the PPF? 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. Do not worry about page 242.

Chapter 11: What are the classical assumptions? 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 SRAS like Panel B of figure 11-9? 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. The prices of inputs only temporarily affect the costs of production unless the economy is moved to full employment. Since expected future price increases will increase wages, which are an input price, it will move only the SRAS. 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: 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? 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.

Nongraded assignment #6A

To be reviewed on 04/09 when assignment #6 is handed back.

- 1) (40 points) Illustrate an increase in the value of the dollar on the foreign exchange market on the 45° diagram, a.k.a. Keynesian cross diagram and the SRAS/LRAS/AD diagram. Explain why the curves moved as drawn.
- 2) (25 points) Illustrate an increase in government spending on the 45° diagram, a.k.a. Keynesian cross diagram. Explain why the curve(s) moved as drawn. **On your graph**, what is your estimate of the multiplier? Explain how you got that number.
- 3A) (15 points) Explain the multiplier process. Why is the change in GDP larger than the change in government spending?
- 3B) (10 points) Given your answer in part A, would an income tax increase or decrease the government spending multiplier? Why would it have that effect?
- 4) (10 points) Suppose that $C = 90 + 0.9Y$ and $Y = 1000$. Find the MPC, MPS, APC, and the APS. Show all work.