Wilfrid W. Csaplar Jr. Principles of Macroeconomics Review Sheet for Exam 3 & HW #6A.

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.

The optional review session for this test will be Tuesday 3/30 at 7:00 in a room to be announced.

The economics club is showing *A Beautiful Mind* on Sunday, 3/28 at 7:00 in Maxwells. All are invited.

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, 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.

Chapter 11: What are the four 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. How does it relate to labor supply and labor demand? 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?

Wilf Csaplar Jr. Economics 162 Homework #6A To be covered on 3/29

This is a non-graded homework assignment that will be covered during the class when we cover assignment #6. The purpose of this assignment is to give you sample questions for the material we covered after you handed in homework #6. This material will be on the exam.

1) (30 points) Illustrate an increase in government spending on the 45° diagram, a.k.a. the Keynesian Cross diagram. Explain why the curve(s) moved as drawn. Given your diagram, what is your estimate of the autonomous expenditure multiplier. Explain your logic.

2) (15 points) If we change our model so that there is an income tax, what would happen to the size of the multiplier? Explain your logic.

3) (15 points) Suppose that a person's consumption function is given by $C = 50 + 0.9Y$. If their income is $10,000, then how much is their MPC, APC, MPS, and APS. If their income is $20,000, then how much is their MPC, APC, MPS, and APS. Show all work.

4) (20 points each) Illustrate the following events on separate the 45° diagrams, a.k.a. the Keynesian Cross diagrams. Explain why the curve(s) moved as drawn.
A) The MPC increases.
B) The Canadian economy improves.