

ECON 331 STUDY GUIDE TEST 1

Chapter 1:

- three basic models describing the economy (short description of each);
- very long run growth (income growth through time, AD-AS diagram, the shape of the AS, which curve/curves determine the output and prices, inflation and the MS);
- short run model (AD-AS diagram, the shape of the AS, which curve/curves determine the output and prices);
- medium run model (AD-AS diagram, how the short-run AS becomes the long-run AS);
- business cycles (the graph with actual GDP and potential GDP, recessions, recoveries, peaks, troughs);
- output gap;

Chapter 2:

- definition of GDP;
- factors of production; factor payments; the implicit expression for a production function;
- Net Domestic Product (definition);
- definition of the National Income through Net Domestic Product and business taxes;
- total demand for domestic output and the components of the total demand (C, I, G, NX);
- major simplification: National Income \equiv GDP;
- disposable income (formula);
- the expression: $S - I = (G + TR - TA) + NX$ (know all the components, know how to handle the components: all the questions from HW1);
- $(G + TR - TA)$ as the government budget deficit;
- “final” goods versus “intermediate” goods (know the difference);
- problems in measuring GDP;
- nominal variables versus real variables (formula for inflation, relation between the current prices and previous period prices, converting nominal variables into real variables, different price indexes);
- unemployment rate (the unemployed, the employed);
- real interest rates and nominal interest rates;
- exchange rates;

Chapter 5:

- definition of AD (the slope);
- definition of AS (the slope);
- different outcomes of the AD-shift (when AS has different slopes);
- the classical AS in the long-run;
- the Keynesian AS in the short-run;
- frictional unemployment and full employment;
- AS and the price-adjustment mechanism;
- the speed of adjustment (λ : slow adjustment versus fast adjustment);
- AD and the real Money Supply (explanation of the slope of the AD);
- AD policy under the classical assumptions and the Keynesian assumptions;
- supply-side economics (AS growth versus AD growth);

Chapter 6:

- the original Phillips curve (wage growth rate versus unemployment rate, formula for the curve – I expect you to be fluent with the formula);
- the unemployment gap; trade-off between the wage rates changes and unemployment rate changes;
- expected inflation and its inclusion into the Phillips curve;
- long-run and short-run Phillips curves;
- surprised versus predictable shifts in money growth (which ones produces results and which ones do not and why?);
- stickiness of wages: reasons the labor force adjusts slowly;
- price stickiness (Okun's law – translation of output into employment; the link between prices and costs);
- know well and understand well the connection between the output-unemployment translation, prices-costs translation, and the explicit expression for AS curve;
- supply shocks (adverse and positive shocks);

Chapter 7:

- the largest cost of unemployment;
- the major cost of inflation;
- five characteristics of unemployment;
- the unemployment pool (what is it; the reasons workers enter the pool, the reasons workers exit the pool);
- frictional, full, and cyclical unemployment – the relationship between;
- labor market turnover;
- a spell of unemployment;
- the duration of unemployment;
- “jobless recovery” – what does it mean?
- factors affecting the duration of unemployment;
- the frequency of unemployment;
- unemployment benefits (the replacement ratio, reservation wage, employment stability);
- expected versus unexpected inflation;
- expected inflation (costs - of holding cash, “shoe-leather”, menu);
- unexpected inflation and borrowing;
- inflation and redistribution of wealth, income, changes in tax structure;
- inflation and indexation