

Exam 2: Key Concepts and Definitions

- Labor force, employment and unemployment
- Labor market indicators
- Frictional, structural and cyclical unemployment
- Natural unemployment
- Full employment
- Potential GDP, output gap
- Capital vs. financial capital
- Investment and depreciation
- Nominal and real interest rate
- Loanable funds market: demand, supply and equilibrium
- The difference between the quantity demanded/supplied and demand/supply
- What causes shifts in curves and what causes movements along a curve
- The difference between short-run and long-run time spans
- Potential GDP and why it could increase/decrease
- What causes shifts in *LAS*, *SAS*, *AD*, *APE* curves, and the sequence of these shifts depending on a particular situation
- What shifts in the long-run vs. what shift in the short-run
- Intertemporal substitution effect
- Short-run and long-run macro equilibria
- What represents economic growth and inflation in the AS-AD model
- Aggregate planned expenditure and its components
- Disposable income and the identities related to it
- Consumption function and characteristics/meanings of its slope and intercept
- Consumption vs. saving
- Induced vs. autonomous consumption
- Induced vs. autonomous expenditure
- The slope in consumption function vs. the slope in the *APE* function
- Actual vs. planned expenditure
- Equilibrium expenditure
- Keynesian cross
- Expenditure multiplier and its derivation

- The magnitude of the multiplier in the shortest run, short-run, and long-run
- Relation of AE model to AS-AD model
- Why is the concept of multiplier important?
- Business cycle and its components (peak, trough, etc.)
- Why should we care about the business cycle?
- The business cycle in the AS-AD framework
- Inflation cycles and their relation to the business cycle
- Demand-pull inflation: definition, examples (hypothetical and historical), and its graphical representation
- Cost-push inflation: definition, examples (hypothetical and historical), and its graphical representation
- Fiscal policy
- Federal budget
- Government receipts and outlays, main components of both
- Government surplus/deficit
- Balanced budget
- Government debt
- Government bond
- Effects of fiscal policy on economy
- Labor tax wedge
- Capital income tax wedge
- Laffer curve
- Fiscal stimulus, its types
- Structural vs. cyclical surplus/deficit

Formulas

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|-------------------------------------|--|
| Unemployment rate (%): | $UR = \frac{\text{unemployed}}{\text{labor force}} \cdot 100$ |
| Employment-to-population ratio (%): | $EPR = \frac{\text{employed}}{\text{working age population}} \cdot 100$ |
| Labor force participation rate (%): | $LFPR = \frac{\text{labor force}}{\text{working age population}} \cdot 100$ |
| Real interest rate (%): | $r = i - \pi$ |
| Accounting identity: | $GDP = C + I + G + NX$ |
| Aggregate income: | $Y = GDP$ |
| Aggregate expenditure: | $AE = GDP = Y$ |
| Aggregate planned expenditure: | $APE = C^P + I^P + G^P + MX^P$ |
| Disposable income: | $YD = Y - T$ |
| Saving: | $S = YD - C$ |
| Consumption function: | $C = a + b \cdot YD$ |
| Expenditure multiplier: | $M = \frac{1}{1 - \text{slope of APE curve}}$ |
| Government budget balance: | $\text{receipts} - \text{outlays}$ |
| Income tax wedge: | $\text{Real wage}^{\text{before tax}} - \text{Real wage}^{\text{after tax}}$ |
| Capital gain tax wedge: | $\text{Real interest rate}^{\text{before tax}} - \text{Real interest rate}^{\text{after tax}}$ |

How to study for the test

1. Make sure you understand all the concepts on page 1.
NOTE THAT THE MATERIAL ON THE TEST WILL NOT BE LIMITED TO THE CONCEPTS AND DEFINITIONS LISTED ON PAGE 1. HOWEVER, IF YOU KNOW THESE, YOU WILL BE ABLE TO ANSWER THE MAJORITY OF QUESTIONS CORRECTLY.
2. Know formulas on page 2
3. Redo the homework
4. Do the practice tests
5. Try to come up with your own examples – this is a very good way to find out whether you truly understand a concept or not
6. Practice graphs a lot

The class slides cover all the concepts you should know for the test. The textbook is there for you to get a better understanding of what is in the slides. If we didn't cover in class something that is in a textbook chapter, you are not responsible for it.