

Econ 202 Final Exam Study Guide

Chapter 2:

1. **Law of Demand**: the higher the price the less the quantity demanded
2. **Law of Supply**: the higher the price the larger the quantity supplied
3. **Production Possibilities Curve**: shows the possible combinations of products that an economy can produce, given that its productive resources are fully employed and efficiently used.
 - Points on the curve are efficient and indicate economy is utilizing all resources
 - Points inside the curve are inefficient and indicate an economy is not utilizing all resources
 - Points outside the curve are not feasible given current technologies and resources
 - Shifts in the PPC show how points outside are feasible in the future if it shifts out due to increases in resources or technological innovation
2. **Marginal Principle**: consume up to the point where $MB=MC$
 - **Marginal Benefit**: additional benefit resulting in a small increase in activity
 - i. Slope increases to the right
 - ii. Slope decreases to the left
 - **Marginal Cost**: additional cost resulting in small increase in activity
3. **The Principle of Voluntary Exchange**: people act in their own self-interest are better off
4. **The Principle of Diminishing Returns**: in the short run, if use of one input is increased while all others are held constant, production will eventually increase at a decreasing rate.
5. **The Real-Nominal Principle**: real value or purchasing power of money/ income is what matters, not its face value
 - **Nominal Value**: face value
 - **Real Value**: value in terms of what it can buy

Chapter 4

1. **Normal Good**: a good for which an increase in income increases demand
2. **Inferior Good**: a good for which an increase in income decreases demand
3. **Substitutes**: two goods for which an increase in the price of one good increases the demand for the other good. As the price of a good falls, people are likely to substitute their normal good for that one instead
4. **Complements**: two goods for which a decrease in the price of one good increases the demand for the other good
5. **Income Effect**: affects all goods not just the one whose price has fallen. As the price of a good falls, people are likely to buy more of all normal goods
6. **Determinants of Demand**: income, price of related goods, population, taste, consumer price expectations
7. **Determinants of Supply**: input costs, technology, # of firms, producer price expectations
8. **Demand vs. Supply Shifts**:
 - **Demand**: both move in the same direction
 - **Supply**: move in the opposite direction

Chapter 5

1. **Macroeconomics:** is the study of the nation's economy as a whole
 - Focuses on inflation, unemployment, and economic growth
 - NO INDIVIDUAL FOCUS
2. **Inflation:** the sustained increase in the average prices of all goods and services
3. **GDP:** total market value of all final goods and services produced in the economy in a given time period
 - GDP= sum of consumption, investment, government spending and net exports
 - Does not include intermediate goods
 - Fluctuations in GDP: peak, trough, expansion, depression
4. **Intermediate Good:** a good used only in the production of other products
5. **Real GDP:** controls price change, holds price constant and can only increase if output goes up
6. **Nominal GDP:** the value of GDP in current dollars (FINAL goods and services), can increase because prices go up and/or output goes up
7. **Consumption Expenditure:** purchases of newly produced goods or services by households
 - Include durable goods, non-durable goods, and services
8. **Durable Goods:** something that lasts over a year (refrigerator)
9. **Non-Durable Goods:** something that doesn't last a long time (food)
10. **Depreciation:** the wear and tear on private investment
11. **Trade Surplus:** exports > imports
 - **Trade Surplus= $\frac{\text{excess of exports}}{\text{imports}}$**
12. **Trade Deficit:** selling assets to individuals or governments in foreign countries
 - **Trade Deficit= $\frac{\text{excess of imports}}{\text{exports}}$**
13. **Growth Rate= $\frac{(\text{Year 2} - \text{Year 1})}{\text{Year 1}}$ - inflation**

Chapter 6

1. **Cyclical Unemployment:** occurs during fluctuations in real GDP including recessions and booms
2. **Frictional Unemployment:** occurs with the normal workings of the economy, such as workers taking time to search for suitable jobs and firms taking time to search for qualified jobs
3. **Structural Unemployment:** occurs when there is a mismatch of skills and jobs
4. **Natural Rate of Employment:** when there is no cyclical employment
5. **Full Employment:** occurs when the unemployment rate= the natural rate
 - When cyclical unemployment rate is at zero
6. **Consumer Price Index:** measures the cost of a fixed basket of goods chosen to represent the consumption pattern of individuals
 - The price index is always 100 in the base year

7. **Inflation:** percent change in a price index
8. **Primary Cost of Deflation:** repaying debts

Chapter 7

1. **Classical or Full employment Economics:** the study of economics when it operates at or near full employment (prices adjust)
2. **Keynesian Economics:** concerned with business cycle or economic fluctuations
3. **Real Business Cycle Theory:** explains how shocks to technology causes fluctuations in economic activity, explains why recessions and booms occur
4. **Principle of Diminishing Returns:** output increase at a decreasing rate
 - No change in capital but doubles its labor input, its output increases by less than 50%
5. **Labor Curve:** inverse relationship between the real wage and the amount of labor hired
6. **Demand of Labor:** firm behavior
 - Inverse relationship between the real wage and the amount of labor hired
 - **Capital Stock: ONLY SHIFTS DEMAND, SUPPLY REMAINS SAME**
 - **Increases in the capital of stock determined by net exports**
7. **Supply of Labor:** consumer choice between work and leisure
 - **Tax shifts labor of demand to the left**
 - **If labor supply is vertical, tax increase will have no effect on output**
8. **Substitute effect:**
9. **Income effect:**
10. **Full-Employment Output:** level of output produced when the labor market is at equilibrium
11. **Crowding Out:** decline in GDP components caused by government spending
12. **Short-run Production Function:** period of time which at least one input is fixed
13. **Real Wage:** the wage rate paid to employees adjusted for changes in the price level
 - Quantity of labor demanded = quantity of labor supplied

Chapter 8

1. **GDP per Capita:** “per person” grows over time because of capital deepening and technological progress
2. **Capital Deepening:** increase in capital per worker while holding constant number of workers, which increases the demand for labor and shifts the production upward
3. **Technological Progress:** occurs when the economy gets more output without any more capital or labor
4. **Exchange Rate:** in order to make comparisons between countries we need to know how much one country’s currency could buy in another
5. **Strong currency vs weak currency:**
 - “Strong”: if the U.S. dollar can buy a lot of other countries currency
 - “Weak”: if the U.S. dollar cannot buy a lot of other countries currency
6. **Higher Saving:** (income not consumed) leads to higher gross investment i.e. increases in the stock of capital
7. **Gross Accounting:** divides growth into its sources of increased capital, labor and technological progress