Econ Final review CHAP 12, 13, 15, 16

CHAP 1-4
Macro – mainly focus on aggregate behavior as a whole
Opportunity cost- highest valued alternative that you would give up to do something
PPC – relationship between production of 2 different types goods, when it shifts outward it means economy as a whole increases, it will shift inward when the economy is doing bad,
Demand vs quantity demanded
Supply vs quantity supplied
Look at LRAS, AD,

CHAP 12 (Consumption, Real GDP, and the Multiplier)

12.1 Simplifying assumptions in a Keynesian Model

Real disposable income = Real GDP – net taxes
Consumption = spending on new goods and services, it is a flow variable
Saving = the act of not consuming all of one's current income, it is an action measured over time (a flow)
Consumption, saving, investment are all flow variables
Savings are a stock, an accumulation resulting in the act of saving in the past
Accounting identity
(C) Consumption + (S) Saving = (DI) Disposable Income
Consumption goods = goods bought to use up, food & movies
Investment or fixed investment = businesses spend on things for the future
Inventory investment = changes in business inventories

12.2 Determinants of Planned Consumption and Planned saving

in the classical model, supply of saving was determined by rate of interest, the higher the rate the more people wanted to save and the less they wanted to consume.

Keynes said that interest rate did not matter, families will save based on what their disposable income is.
The life cycle theory of consumption = says that when one anticipates a higher income in the future, they will consume more and save less
The permanent income hypothesis = looks at average income over the long run
Consumption function = relationship between how much is consumed and disposable income, shows a positive relationship between disposable income and planned consumption, along the 45-degree line expenditures = DI
When consumption = 0 that is the break even point
Break even point for consumption when saving = 0, also every point on the 45 degree line
Dissaving = when spending exceeds income

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Autonomous consumption- is independent from DI
When planned consumption = Real DI then saving = 0
Average Propensity to consume (APC) = Real consumption / Real disposable income
Average propensity to Save (APS) = Real saving / Real disposable income
Marginal Propensity to consume (MPC) = Change in real consumption / change DI
Marginal Propensity to save (MPS) = change in real saving / change in real DI
APC + APS = 1
MPC + MPS = 1

12.3 Determinants of investment
Investment consists of expenditures on new buildings and equipment
As the rate of interest (%) goes up the planned real investment per year goes down
An expectation of higher future gains increases level of investment
Purchases of corporate stock is not included in the flow of investment spending
The planned investment function shows a negative or inverse relationship between interest rate and planned investment
The most variable over time is real investment spending
Decrease in taxes = increase in planned investment demand

12.4 Determining Equilibrium Real GDP
we want to determine the equilibrium level of real GDP per year
Consumption as a function of real GDP

If a firms unplanned inventories are increasing then consumers are saving more than business anticipated
Equilibrium GDP is determined by the intersection of planned saving and planned investment schedules
Only at equilibrium GDP will planned saving = actual saving
Planned investment = actual investment
Planned saving = planned investment
Investment is autonomous with respect to GDP
LOOK AT MORE

AD = C + investment (I) + G + X

12.5 Keynesian equilibrium

Government (G) C + I + G
Lump sum tax, doesn't depend on income of taxpayer
Government purchases are determined by political process

The foreign sector (X) Net exports – imports
When
C + I + G + X = Y we have equilibrium GDP
> Y unplanned decrease in inventories, businesses raise output
< Y unplanned increase in inventories, businesses reduce output

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12.6 the multiplier

1/MPS is the multiplier
remember MPS = 1-MPC
so the larger the MPC the larger the multiplier
and the larger the MPS the smaller the multiplier
The multiplier effect tends to magnify small changes in spending into larger changes in real GDP
Change in equilibrium real GDP = multiplier * Change in autonomous spending
The multiplier helps explain why a rise in government expenditures causes real GDP to rise by more than the amount of the increase in government spending

12.7 change in autonomous spending affects real GDP
If ag. Supply curve is upward sloping, then an increase in autonomous consumption leads to an increase in aggregate demand and a rise in price level

12.8 relationship between aggregate demand and C + I + G + X Curve
consumption, investment, government, foreign sector
AD curve has price level changing, the C + I + G + X curve does not
Higher price level causes the C + I + G + X Curve to shift down
A rise in price level causes a reduction in total planned real expenditures

CHAP 13 Fiscal Policy

13.1 discretionary fiscal policy
When the government diliberatly alters its level of *spending* and/or *taxes* in order to receive national economic goals it is exercising discretionary fiscal policy
An increase in government spending will stimulate economic activity, shift the AD right
Example of fiscal policy is reduction in lump sum taxes
Changes in government spending, military spending, education spending, budgets for agencies.
Change in taxes, a rise in taxes causes a reduction in aggregate demand because it can reduce everything else
Decrease in taxes will cause increase in demand
Tax and spend policy = fiscal policy
Has to do only with tax level changes and government spending changes
If there is inflationary gap = increase taxes
Recessionary gap = decrease taxes
Full employment when LRAS (vertical) = SRAS

13.2 Possible offsets to fiscal policy