

Chapter 7

- Know and understand the definition for Gross Domestic Product (GDP)
 - Gross Domestic Product (GDP): The market value of all final goods and services produced within a country during a specific period (usually a year).
- Understand what transactions get included into GDP and what transactions are left out.
 - Included:
 - Final goods/services: goods and services purchased by their ultimate user
 - Only goods and services that are produced are included in GDP.
 - GDP counts only goods and services produced within the geographic borders of a country. ex. Production of a Japanese car factory in the U.S. is included in U.S. GDP.
 - Only goods produced in 2008 are included in the figure for 2008 GDP
 - Not included:
 - Intermediate goods/services: Goods purchased for resale or for use in producing another good or service
 - transfers are not. Ex. \$100 graduation gift, Welfare payments, Financial transactions (note: sales commission would be counted in GDP).
 - Production of an U.S Nike Shoe factory in Indonesia is not included in U.S GDP
- Know the two approaches for finding GDP:
 1. Expenditure approach: $Y = C + I + G + NX$ (understand what goes into each of these components and be able to calculate Investment, inventory investment, and Net Exports so that you can calculate GDP)
 - $Y = \text{GDP}$
 - $C = \text{Consumption}$: Household spending on goods and services during the current period.
 - $I = \text{Investment}$: production or construction of capital goods that provide future service.
 - Investment – depreciation = Net investment
 - $G = \text{Government}$: capital goods.
 - Does not include transfer payments
 - Government expenditures are counted at cost (not value) to tax payers.
 - $NX = \text{Net Exports}$: Exports – Imports.
 2. Resource cost-income approach: $Y = \text{employee compensation} + \text{proprietor's income} + \text{rent} + \text{corporate profits} + \text{interest income} + \text{indirect business taxes} + \text{depreciation} + \text{Net income of foreigners}$.
- Know and understand the definition for Gross National Product (GNP), and know how it is different from GDP
 - GNP: total market value of all final goods and services produced by the citizens of a country.
 - Counts the income Americans earn abroad
 - Ignores the income foreigners earn in U.S.
- Know the difference between nominal and real values and know how to calculate real values.
 - Nominal Values: values expressed in current dollars
 - Real Values: Values that have been adjusted for the effects of inflation
 - Percentage of nominal return – inflation percentage = real value

- Know how to calculate a price index and know the two most common price indexes:
 - Cost of bundle in current year/cost of bundle in base year
- 1. Consumer Price Index (CPI): Indicator of general level of prices. Compares the cost of a typical market basket in a specific period to the cost of the same basket in a different period.
- 2. GDP Deflator: reveals the cost during the current period of purchasing the items included in GDP relative to the cost during the base year.
- Understand the limitations to using GDP as a measure of productivity
 1. Excludes non-market production
 2. Excludes the underground economy
 3. Excludes leisure and human costs
 4. Difficult measuring quality variation and introduction of new goods
 5. Excludes the costs of harmful side effects.
- Know how to calculate GDP per capita and understand that it is used as a broad indicator of general living standards.
 - Per capita GDP= GDP/Population

Chapter 8

- Understand the idea of business cycles and how they are measured
 - Business cycle: Fluctuations in the general level of economic activity
 - Usually measured by two variables:
 - Changes in real GDP
 - Unemployment rate
- Know the business cycle definitions: expansion, peak, contraction, trough, recession, depression
 - **Expansion:** characterized by growing GDP and declining unemployment
 - **Peak (boom):** the height of the expansion phase
 - **Contraction:** characterized by falling GDP and rising unemployment
 - **Trough:** The lowest point of the contraction phase
 - **Recession:** A decline in real GDP for two or more consecutive quarters
 - **Depression:** A prolonged and severe recession
- Understand the labor market definitions and know who gets counted as employed and unemployed. Be able to calculate:
 1. Civilian Labor Force: Number of people age 16 or older who are employed or unemployed.
 2. Labor Force Participation Rate: Percent of population age 16 and over who is in the civilian labor force.
 3. Unemployment Rate: percentage of people in the labor force who are unemployed
 4. Employment / Population Ratio: Percent of population age 16 and over who are employed.
 - **Employed:** Person is employed if he or she has worked full or part-time (even a few hours) in the past week or is on vacation or sick leave from a regular job
 - **Unemployed:** A person who is not currently employed, but is
 - actively seeking employment (in last 4 weeks) or
 - waiting to start or return to a job
- Understand the 3 types of unemployment:

1. Frictional Unemployment (U^f): Unemployment resulting from changes in the economy and imperfect information that prevents workers from being immediately matched up with existing job openings.
 2. Structural Unemployment (U^s): Unemployment due to structural characteristics of the economy that prevent the matching of available jobs with available workers.
 3. Cyclical Unemployment (U^c): Unemployment due to recessions and inadequate labor demand.
- Understand that Natural Unemployment (U^*) is the combination of Structural Unemployment and Frictional Unemployment and is not fixed but affected by the structure of the labor force and public policy.
 - Know that Actual Unemployment (U) is the sum all three types of unemployment and understand the relationship between Actual Unemployment and Natural Unemployment within the business cycles:
 1. Expansion: $U^* > U$
 2. Recession: $U^* < U$
 3. Full Employment: $U^* = U$
 - Understand the concept of Potential Output (Y^p): The level of output that can be achieved and sustained in the future, given:
 1. the size of the labor force
 2. expected productivity (quality of labor)
 3. natural rate of unemployment
 and know how it relates to business cycles:
 1. Expansion: Actual output (Y) $>$ Potential output (Y^p)
 2. Recession: Actual output (Y) $<$ Potential output (Y^p)
 - Understand the concept of inflation and how to calculate it. Know the problems of high and variable inflation:
 - Inflation: An increase in the general level of prices (percent change in prices).
 1. Reduces investment
 2. Distorts the information delivered by prices
 3. Results in less productive use of resources
 - Know the main sources of high inflation:
 1. Demand rising faster than supply
 2. Rapid increase in the money stock

Chapter 9

- Understand the market for goods and services: know why the demand curve is downward sloping, the supply curve is upward sloping, the idea of market equilibrium, and how a change in demand or supply affects equilibrium price and quantity. (Review from chapter 3)
 - Price for labor is called the wage (w)
 - Quantity of labor is called employment (E)
 - Labor demand curve is downward sloping because as wage decreases, firms will want to employ more people
 - Labor supply curve is upward sloping because as wage increases, people will want to work more.
 - Market equilibrium: A state in which the conflicting forces of supply and demand are in balance.