

Exam I

Term	ID	Significance
Competitive market	market with large number of independently acting buyers and sellers who cannot individually influence price	Competitive markets come to rest with a price and quantity mutually satisfactory to the buyers and sellers (as if by an invisible hand, they reach market clearing prices and quantities)
Entrepreneurship	Human resource that brings together other resources and is motivated by profit (self-interest)	Entrepreneurs bear risk; are innovators
Minimum wage law	Legal price floor imposed in the labor market	If set above equilibrium wage, creates unemployment or surplus of labor; concentrated on least-skilled workers; unions support higher minimum wages
Real GDP	The value of all domestically produced goods and services evaluated at constant prices	Indicator of the real level of economic activity (the quantities of goods and services produced domestically)
Explicit and implicit economic costs	Explicit = "out of pocket" costs; costs paid in money Implicit = value of alternatives foregone when a decision is made (no direct money payment)	Both costs must be taken into consideration if economic decisions are to be 'rational'; even when explicit costs are not made, implicit costs are real and often quite sizeable
Legal price floor	Prices set by law below which legal transactions cannot occur	If set above the equilibrium prices, can result in excess supply or surpluses
Opportunity cost	Alternatives foregone when a choice is made	Both explicit and implicit opportunity costs are necessary for rational decision making
Capital	Human-made aids to production; goods used to produce other goods; plant, equipment, machinery, etc.	More capital, ceteris paribus, implies higher economic growth
Parity price ratio	Index of farm prices/index of non-farm prices x 100	Often cited in agricultural policy discussion about raising farm prices; indicator of how the farm sector is doing economically; when the ratio fell below 100% in the 30s, there was political pressure to establish price supports (floors) which resulted in surpluses
Price elasticity of demand	$E_D = \left \frac{\% \Delta Q_d}{\% \Delta P} \right $ (absolute value of percentage change in quantity demanded over percentage change in price); measure of how responsive buyers are to changes in price of a good/service, ceteris paribus	Relationship with TR (TR=PxQ; If $E_D > 1$ (elastic), P and TR change in opposite direction; if $E_D < 1$ (inelastic), P and TR change in same direction); relationship with economic tax incidence
MPC	$\Delta C / \Delta Y_D$, the marginal propensity to consume, which is the proportion of additional current disposable income that is spent on consumption	It is the slope of the consumption function. According to Keynes, $0 < MPC < 1$
APC	C / Y_D , the average propensity to consume, or the proportion of current disposable income spent on consumption	At the break-even level, APC=1 (implies zero saving), APC>1 => dissaving, APC<1 => saving. According to Keynes, as disposable income increase, APC decreases ($Y_D \uparrow \Rightarrow APC \downarrow$)

Exam II

How inflation affects creditors and debtors	Unanticipated inflation reduces creditors' real income while benefit debtors who repay their loans with dollars of lower purchasing power	If inflation is anticipated , they will increase nominal interest rates in an effort to preserve real rates
Quantity Theory of Money	$\% \Delta M^s + \% \Delta V = \% \Delta P + \% \Delta Q$	With $\% \Delta V = 0\%$, $\% \Delta P$ (inflation or deflation) depends on $\% \Delta M^s$ compared to $\% \Delta Q$ ($\% \Delta M^s > \% \Delta Q \Rightarrow \% \Delta P > 0 \Rightarrow$ inflation and ($\% \Delta M^s < \% \Delta Q \Rightarrow \% \Delta P < 0 \Rightarrow$ deflation)
Three functions of money	Medium of exchange Unit of account Store of value	Facilitates exchanges of material goods and services Facilitates estimates of comparative values; "common denominator" valuing goods and services Allows purchasing power to be stored over time; how well money performs over time depends on changes in the price level
Unemployment	Percentage of the labor force without jobs;	Economy produces less than it could (GDP gap); non-economic costs such as political and family instability, higher crime rates, health problems among the chronically unemployed
3 types of unemployment	<i>Structural</i> – workers lack marketable skills; <i>Frictional</i> – workers voluntarily changing jobs and new entrants into the labor force; <i>Cyclical</i> – joblessness associated with the ups and downs of the business cycle	Economy produces less than it could (GDP gap); non-economic costs such as political and family instability, higher crime rates, health problems among the chronically unemployed; <i>Frictional unemployment</i> is desirable when it increases worker productivity or efficiency and improves job "matches"; it is assumed to be ~5%.
Economic costs of unemployment	GDP gap (dollar value of all goods and services not produced domestically due to involuntary joblessness)	Involuntary unemployment means that we are not producing as many material goods & services as we could; non-economic costs may also be mentioned
Three policies to combat inflation	Higher legal reserve requirements Higher discount rate Sell bonds in open market operations	Commercial banks hold larger reserves, so less money in the economy $\Rightarrow M^s \downarrow$ Commercial banks and public have more difficulty (more expensive) borrowing $\Rightarrow M^s \downarrow$ Fed gives out bonds and takes in cash $\Rightarrow M^s \downarrow$
Inventory adjustment mechanism	If planned TE does not equal AS_K (line showing planned and actual expenditure), then the economy is not in equilibrium	Inventory adjustments presumably bring the economy to rest. If, for example planned TE $> AS_K$, there will be an unintended drop (or decumulation) of inventories, and vice versa
GDP gap	Difference between actual (equilibrium) Y_e and noninflationary full-employment Y^* , where $Y^* > Y_e$; dollar value of all goods and services not produced due to involuntary joblessness	The gap indicates unemployment as the problem; measure of the economic costs of unemployment
Excess reserves	Total reserves – legally required reserves = excess reserves	Only legal source of funds that commercial banks can lend; if banks hold positive excess reserves, money supply changes are not as large as they could be
Different interest rates	a) Differences in default risk b) Differences in term to maturity c) Differences in tax treatment	a) Risk that a lender may not be paid back; i.e. the borrower will default on their promise to repay the loan (US gov't Treasury bonds have zero default risk b) How long until the IOU must be repaid (higher

		maturity=> higher interest rate) c)Interest rate paid on IOUs issued by state or local gov't is not subject to income tax (tax-free/tax-exempt municipal bond), so no income tax=>lower interest rate than identical taxable bonds
Consumer wealth	Value of assets<minus>value of liabilities; financial assets (stocks, bonds, etc) and durable goods owned by consumers	Changes in consumer wealth can shift the consumption function and alter the level of economic activity
Three motives for holding money (cash)	a)transactions demand b)speculative demand c)precautionary demand	a)carry out day-to-day transactions b)in case of a decrease in asset prices c)in case of unforeseen events
Wizard of Oz	Political allegory reflecting movements during the late 19 th century	Dorothy wears ruby slippers in the movie, but in the book, they are <i>silver</i> . This is representative of the silver standard, just as the yellow brick road is representing the gold standard. The combination is the desire for a bimetallic standard. Many hidden meanings: e.g. Wizard of Oz (oz. being the abbreviation for ounce, as in gold), wicked witch of the east (eastern financial and business interests), and the list goes on...
Tax multiplier	$\frac{-MPC}{1-MPC}$	The size of M_{TAX} depends on the MPC, that is, with a lower MPC, M_{TAX} is smaller (and vice versa) $MPC = 0.8 \Rightarrow M_{TAX} = -4$ $MPC = 0.75 \Rightarrow M_{TAX} = -3$
Money expansion multiplier	$\Delta M^s = \frac{1}{RRR} \times \Delta total\ reserves$	Changes in the money supply are determined by the required reserve ratio and the change in total reserves; the higher the RRR, the lower the change in money supply