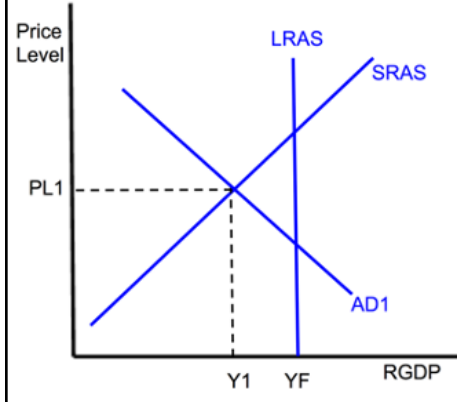
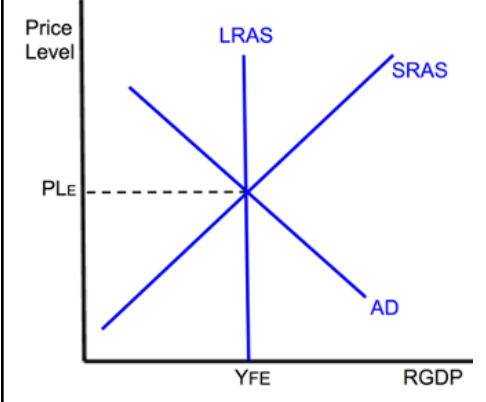
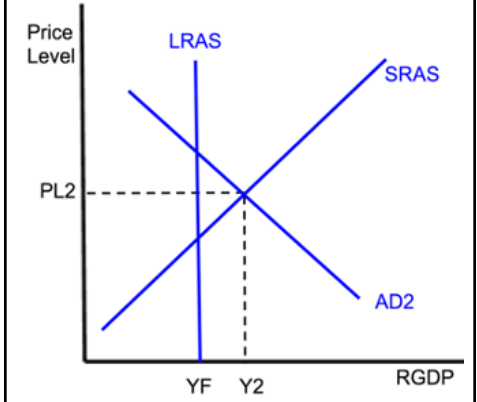




Macroeconomics Unit 3 Study Guide

National Income and Price Determination

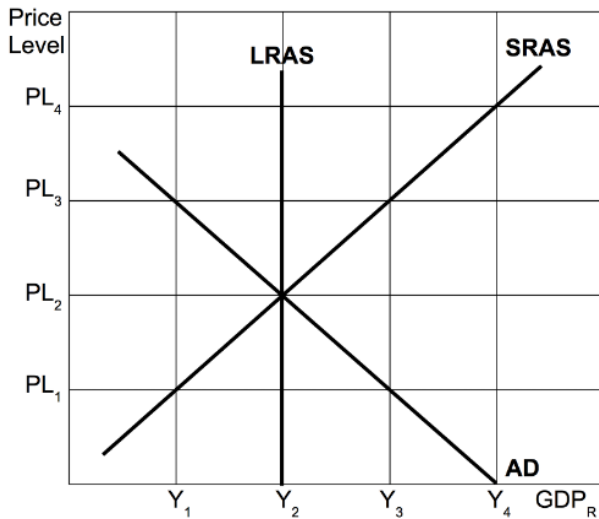
Topic 3.1- Aggregate Demand (AD) ▶	Topic 3.2- Multipliers ▶																																									
<p>1. What is the difference between a market demand curve and the aggregate demand curve? A market demand shows the demand for one good/service at different prices. Aggregate demand shows the demand for all goods and services at different price levels</p> <p>2. What three concepts explain why aggregate demand is downward sloping? Real wealth effect Interest rate effect Exchange rate effect</p> <p>3. What are the shifters of aggregate demand? Anything that changes consumer spending, business investment, government spending, and/or net exports</p>	<p>1. What is the multiplier effect? The idea that an initial change in spending will set off a spending chain that is magnified in the economy. The strength of multiplier depends on the amount that consumers spend of new income.</p> <p>2. Define marginal propensity to consume (MPC). How much people consume rather than save when there is a change in income</p> <p>3. Define marginal propensity to save (MPS). How much people save rather than consume when there is a change in income</p> <p>4. Equation for the simple spending multiplier. $1/MPS$</p> <p>5. Equation for the tax multiplier. MPC/MPS or $1/MPS - 1$</p> <p>6. Fill in the blanks below:</p>																																									
<p>Topic 3.3- Short-run Aggregate Supply (SRAS) ▶</p>	<table border="1" data-bbox="781 884 1521 1377"> <thead> <tr> <th>Initial Change</th> <th>Initial Amount</th> <th>MPC</th> <th>Maximum Change</th> <th>Initial Change</th> </tr> </thead> <tbody> <tr> <td>↓ G</td> <td>\$30 billion</td> <td>.5</td> <td>↓\$60 billion</td> <td>↓ G</td> </tr> <tr> <td>↑ C</td> <td>\$20 billion</td> <td>.9</td> <td>↑\$200 billion</td> <td>↑ C</td> </tr> <tr> <td>↓ Taxes</td> <td>\$10 billion</td> <td>.8</td> <td>↑\$40 billion</td> <td>↓ Taxes</td> </tr> <tr> <td>↑ I</td> <td>\$20 billion</td> <td>.75</td> <td>↑\$80 billion</td> <td>↑ I</td> </tr> <tr> <td>↑ M</td> <td>\$10 billion</td> <td>.9</td> <td>↓\$100 billion</td> <td>↑ M</td> </tr> <tr> <td>↑ X</td> <td>\$10 billion</td> <td>.8</td> <td>↑\$50 billion</td> <td>↑ X</td> </tr> <tr> <td>↑ Transfer Payments</td> <td>\$20 billion</td> <td>.9</td> <td>↑\$180 billion</td> <td>↑ Transfer Payments</td> </tr> </tbody> </table>		Initial Change	Initial Amount	MPC	Maximum Change	Initial Change	↓ G	\$30 billion	.5	↓\$60 billion	↓ G	↑ C	\$20 billion	.9	↑\$200 billion	↑ C	↓ Taxes	\$10 billion	.8	↑\$40 billion	↓ Taxes	↑ I	\$20 billion	.75	↑\$80 billion	↑ I	↑ M	\$10 billion	.9	↓\$100 billion	↑ M	↑ X	\$10 billion	.8	↑\$50 billion	↑ X	↑ Transfer Payments	\$20 billion	.9	↑\$180 billion	↑ Transfer Payments
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<p>1. Why is short-run aggregate supply upward sloping? Wages and resource prices are not flexible in the short-run.</p> <p>2. What are the shifters of short-run aggregate supply? Anything that affects producers and production. Availability and price of resources, actions of the government (business taxes, subsidies, regulation), and expected inflation.</p>																																										
<p>Topic 3.4- Long-run Aggregate Supply (LRAS) ▶</p>																																										
<p>1. Why is long-run aggregate supply vertical? In the long run, wages and resource prices are flexible. When price level increases, wages will increase by the same amount</p>																																										
<p>Topic 3.5- Equilibrium in the AD-AS Model ▶</p>																																										
<p>1. Draw an economy with a negative output gap</p> 	<p>2. Draw an economy at full employment</p> 	<p>3. Draw an economy with a positive output gap</p> 																																								



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National Income and Price Determination

Topic 3.6- Changes in the AD-AS Model in the Short Run ▶



Use the graph to the right to answer the following questions (assume that each event takes places independently)

1. What is the short-run equilibrium price level and output? [PL2 Y2](#)
2. Identify the short-run equilibrium price level and output if consumption increased? [PL3 Y3](#)
3. Identify the short-run equilibrium price level and output after a negative supply shock? [PL3 Y1](#)
4. What happens to output and unemployment if investment falls? [Output↓ Unemployment↑](#)
5. Use the graph to explain the difference between demand-pull and costs-push inflation. [Demand-pull inflation is caused by an increase in aggregate demand and cost-push inflation is caused by a decrease in aggregate supply](#)

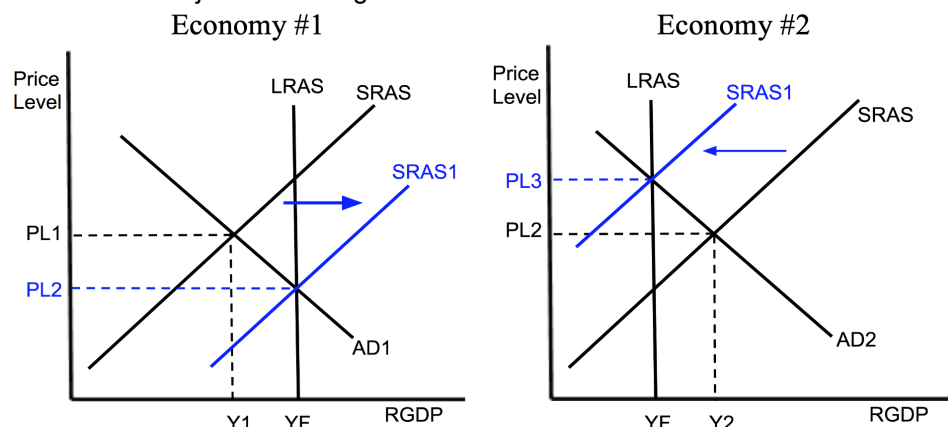
6. What is a negative supply shock? [An unexpected decrease in the availability of a key resource that temporarily decreases productivity](#)
7. What is a positive supply shock? [An unexpected increase in the availability of a key resource that temporarily increases productivity](#)
8. Define stagflation. [When there is high unemployment and high inflation. It is the result of a decrease in SRAS.](#)

9. Define deflation. [A decrease in the general price level. The opposite of inflation](#)
10. What is autonomous consumption? [The minimum amount of consumer spending when people have no income](#)
11. What is disposable income? [The amount of money households have to spend or save after taxes](#)

Topic 3.7- Long-run Self-Adjustment ▶

1. Explain how the economy self-adjusts in the long run when there is a negative output gap. [A decrease in wages and resource prices causes production costs to falls and SRAS to shift to the right](#)
2. Explain how the economy self-adjusts in the long run when there is a positive output gap. [An increase in expected inflation causes wages to increase and SRAS to shift to the left.](#)

3. Assuming wages and resource prices are flexible, show how each economy below will self-adjust in the long run.



4. Assume instead that Economy #2 experiences economic growth. What happens to LRAS and output? [LRAS shifts to the right and output increases.](#)
5. Does the natural rate of unemployment increase, decrease, or stay the same when the LRAS shifts right? [NRU stays the same](#)



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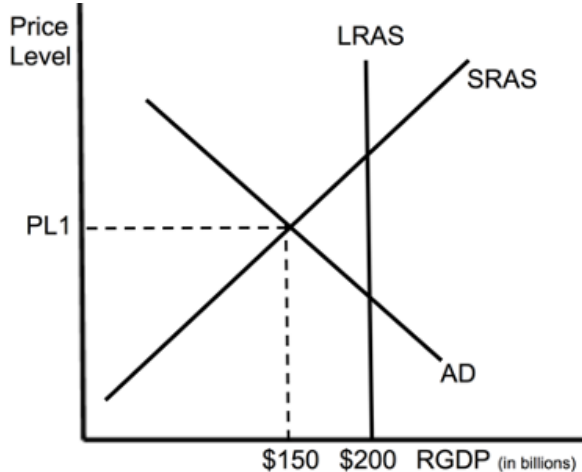
National Income and Price Determination

Topic 3.8- Fiscal Policy ▶

1. Define expansionary fiscal policy. **Laws that increase output by increasing government spending or decreasing taxes**
2. Define contractionary fiscal policy. **Laws that decrease inflation by decreasing government spending or increasing taxes**

3. Explain why an increase in government spending will lead to more total spending than a decrease in taxes by the same amount. **Households save a portion of a tax cut. The tax multiplier is less than the spending multiplier.**

Use the graph to answer the questions to the right. Assume wages and resource prices are flexible.



4. Is there a recessionary gap or inflationary gap? **Recessionary. Actual output below potential**
5. What happens to price level and output in the long run if no policy action is taken? **Price level will decrease, output will increase**
6. Assume instead that the government decides to use fiscal policy. Identify two policies that could close the gap. **Increase in government spending or decrease taxes on consumers**
7. If the MPC is .5, what is the least amount of government spending that could close the gap? **\$25 billion**
8. If the MPC is .5, what is the least amount the government could cut taxes to close the gap? **\$50 billion tax cut**

Topic 3.9- Automatic Stabilizers

1. Define discretionary fiscal policy. **Congress creates a new bill that is designed to change AD through government spending or taxation.**
2. Define non-discretionary fiscal policy. **Permanent spending or taxation laws enacted to work counter cyclically to stabilize the economy**
3. Identify three different examples of automatic stabilizers. **Unemployment benefits, welfare, progressive income taxes, etc.**

9. Assume instead that the MPC is .9. What is the least amount of government spending that could close the gap? **\$5 billion tax cut**
10. Would an increase in private savings increase or decrease the effectiveness of fiscal policy? **Increasing savings will decrease the effective of fiscal policy since the multiplier falls**
11. Why are there lags when the government uses discretionary fiscal policy? **It takes time to decide on and implement a policy action**

Unit Review

True or False:

1. An increase in expected inflation will decrease the short-run aggregate supply. **True**
2. An increase in interest rates will increase investment and aggregate demand. **False**
3. The spending multiplier is weaker than the tax multiplier. **False**
4. Fiscal policy includes government spending and taxation. **True**
5. If the MPS is .2 the tax multiplier is 4. **True**
6. When the MPC increases, the spending multiplier decreases. **False**
7. Jacob Clifford is very attractive. **True?** 😊

Scenario	Change in AD or AS	↑ or ↓
8. Government uses expansionary fiscal policy	AD	↑
9. No policy when there is a recession	SRAS	↑
10. Government increases taxes on consumers	AD	↓
11. There is a decrease in imports	AD	↑
12. Positive output gap. Government takes no policy	SRAS	↓