

# AP Macroeconomics Key Concepts and Terms

Time allotments for each unit are suggested ranges. I may choose to emphasize some areas as I deem appropriate. Knowing the definition is not sufficient: students must also be capable of using the term or concept in explaining solutions to economic problems.

Note also that I may move from one topic to another as I choose. I will warn you prior to following the chapters in a non-linear fashion so that you will be able to read appropriate material in advance of lecture and discussion sessions.

## I. UNIT ONE: *Introduction to Economics and the Economy* (Chapters 1-6, 3-5 weeks)

### A. Chapter 1: *Nature and Method of Economics*

1. Scarcity and Choice
2. Rational Behavior
3. Marginal Analysis: Benefits and Costs of choices
4. *Ceteris Paribus*
5. Fiscal and Monetary Policies
6. Economic Goals
  - a. Growth
  - b. Employment
  - c. Efficiency
  - d. Price Stability
  - e. Freedom
  - f. Distribution of Income
  - g. Security
  - h. Balance of Trade
  - i. Normative vs. Positive

### B. Chapter 2: *The Economizing Problem*

1. Resources
  - a. Land
  - b. Labor
  - c. Capital
  - d. Entrepreneurial Skill (or management skill...)
2. Full employment: not everyone is working
3. Full production
4. Production Possibility Curve (also Production Possibility Frontier)
5. Opportunity Cost
6. Marginal Benefits and Marginal Costs
7. Unemployment and inefficiency
8. Expanding the Production Possibility Curve
9. Economic systems
  - a. Market
  - b. Command
  - c. Traditional
  - d. Mixed
10. Economic Schools of Thought

- a. Classic
  - b. Socialist
  - c. Keynesian
  - d. Neo-classic
  - e. Monetarist
- 11. Circular Flow model
  - a. Resource Markets
  - b. Product Markets
- C. Chapter 3: *Individual Markets: Demand and Supply*
  - 1. Law of Demand
    - a. Determinants of Demand (tastes, number of consumers, incomes, prices of related goods, expectations about the future)
  - 2. Substitute goods
  - 3. Complementary goods
  - 4. Inferior goods
  - 5. Law of Supply
    - a. Determinants of Supply (resource prices, technology, taxes and subsidies, prices of other goods, expectations, number of sellers)
  - 6. Equilibrium
  - 7. Shortages
  - 8. Surpluses
  - 9. Basic Supply and Demand Graphs
    - a. Shifts in Supply
    - b. Shifts in Demand
    - c. Shifts in both Supply and Demand
- D. Chapter 4: *The Market System*
  - 1. Private Property
  - 2. Free Enterprise
  - 3. Free Competition
  - 4. Self-Interest: the Invisible Hand
  - 5. Specialization
  - 6. Money vs. Barter
  - 7. Government Involvement in the Market
  - 8. The Four Economic Questions
    - a. What gets made?
    - b. How will it get made?
    - c. Who gets it?
    - d. How do you handle change?
  - 9. The Power of Prices
- E. Chapter 5: *US Economy: Private and Public Sectors*
  - 1. Functional distribution of income (chart, p.74)
  - 2. Personal distribution of income (chart, p.74)
  - 3. Business Structures
    - a. Proprietorships
    - b. Partnerships
    - c. Corporations

- d. LLC
  - e. S-corporation
- 4. Government
  - a. Legal structure
  - b. Market Involvement
  - c. Redistribution of Income
  - d. Public Goods and Services
  - e. Economic Stability Goals
- 5. Circular Flow + Government (chart, p.84)
- 6. Government Spending
- 7. Government Income
- F. Chapter 6: *US and the Global Economy*
  - 1. Balance of trade
  - 2. Flow of goods
  - 3. Flow of services
  - 4. Flow of funds
  - 5. Faster-growing nations and the US
  - 6. Financing the US debt
  - 7. Specialization
  - 8. Comparative Advantage
  - 9. Foreign Exchange
  - 10. Trade Concepts
    - a. Tariffs
    - b. Protectionism
    - c. Quotas and other nontariff barriers
    - d. Export Subsidies
    - e. Trade Zones: regional and world-wide (NAFTA, EU, WTO, etc.)

II. UNIT TWO: *National Income, Employment, and Fiscal Policy* (Chapters 7-12, selections from Chapters 16-19; 6-7 weeks)

A. Chapter 7: *Measuring Domestic Output, National Income, and the Price Level*

- 1. GDP (Gross Domestic Product)
- 2. Final Goods
- 3. Consumption (C)
- 4. Investment (I<sub>g</sub>)
- 5. Government Spending
- 6. Net Exports
- 7. Expenditure vs. Income method of counting GDP
- 8. Private Economy: "No government sector"
- 9. Closed Economy: "No international sector"
- 10. Personal Income
- 11. Disposable Income
- 12. Circular Flow with Government Involvement, Detailed (chart, p. 126)
- 13. Nominal vs. Real
- 14. Nominal GDP vs. Real GDP
- 15. Price Index

16. Baseline Year
17. CPI (Consumer Price Index)
18. Underground Economy
19. Externalities and GDP
20. Per Capita Output

B. Chapter 8: *Introduction to Economic Growth and Instability*

1. Economic Growth
2. Rule of 70 ( $70/\text{growth \%} = \# \text{ of years to double}$ )
3. Productivity
4. Young economy vs. Mature economy growth
5. Business cycle
  - a. Peak
  - b. Recession
  - c. Trough
  - d. Recovery
  - e. Government Involvement: Smoothing the cycle
6. Durable and non-durable goods
7. Unemployment
  - a. Frictional
  - b. Structural
  - c. Seasonal
  - d. Cyclical
  - e. Discrepancies vs. official and actual unemployment
8. Full employment = Zero Cyclical Unemployment
9. Natural Rate of Unemployment
10. GDP Gap and Okun's Law
11. Bias and employment
12. Inflation
  - a. Demand-Pull Inflation (graph)
  - b. Cost-Push Inflation (graph)
  - c. Inflation hurts fixed-income, savers, creditors
  - d. Inflation helps indexed-income, debtors
  - e. Anticipated inflation
13. Nominal and Real Income
14. Deflation
15. Hyperinflation

C. Chapter 9: *Building the Aggregate Expenditures Model*

1. Consumption
2. Saving
3. MPC (Marginal Propensity to Consume)
4.  $1 - \text{MPC} = \text{MPS}$  (Marginal Propensity to Save)
5.  $1/\text{MPS} = \text{GDP multiplier}$
6. Investment
7. Expected Rate of Return
8. Real vs. Nominal Interest rates
9. Investment is inversely proportional to interest rate

10. Shifts in Investment line: costs, expectations, tech. change, stock, taxes
- D. Chapter 10: *Aggregate Expenditures: The Multiplier, Net Exports, and Government*
1. More on the GDP Multiplier
  2.  $I * \text{Multiplier} = \text{additional GDP}$
  3. Impact of Additional Exports
  4. Impact of Additional Government Expenditure
  5. How to find Net Exports - International Economic Linkages
  6. Assumption: Net Exports and Government Spending are constant at all GDP
  7. Balanced Budget: Multiplier is 1 (one)
  8. Recessionary Gap (p. 195)
  9. Inflationary Gap (p. 195)
- E. Chapter 11: *Aggregate Demand and Aggregate Supply*
1. Graphing: Aggregate Demand and Aggregate Supply
  2. Real Balances, Interest Rate, and Foreign Purchase effects
  3.  $AD = C + I_g + G + X_n$
  4. Aggregate Supply Line
    - a. Horizontal or "Keynesian"
    - b. Intermediate or "Classical"
    - c. Vertical or "Full-Production" or "Inflationary"
  5. Changes in Aggregate Supply
    - a. Resource Price Changes
    - b. Changes in Productivity
    - c. Business Taxes/regulations
  6. Price level and GDP at Equilibrium
  7. Multiplier effects
  8. Decreasing Aggregate Demand: Why Recession?
    - a. Sticky wages
    - b. Sticky prices
  9. Increasing Aggregate Demand: Why Inflation?
    - a. Full capacity
    - b. Wage-price spiral
    - c. Demand-Pull Inflation
  10. Decreasing Aggregate Supply: Cost-Push Inflation
  11. Increasing Aggregate Supply
    - a. Price declines vs. Deflationary spiral
    - b. Increased full output (relates to change in PPC)
- F. Chapter 12: *Fiscal Policy*
1. Legislative mandates
  2. Fiscal Policy and the AD-AS Model
    - a. Expansionary policies (cut taxes, raise spending)
    - b. Contractionary policies (raise taxes, cut spending)
    - c. Deficits
    - d. Surpluses
    - e. Tax cuts and saving
    - f. Multiplier effects
  3. Deficits and crowding-out

- a. Increased borrowing
  - b. Interest rate increases
  - c. Reduced private borrowing
  - d. Controversies about "crowding-out"
- 4. T vs. G: Tax chart (p. 229)
- 5. Tax structures
  - a. Progressive
  - b. Proportional
  - c. Regressive
- 6. Political Business Cycle
  - a. Recognition lag
  - b. Administrative lag
  - c. Operational lags
- 7. Supply-Side fiscal policy
- G. Selections from Chapters 16-19
  - 1. Long-Run Aggregate Supply (LRAS)
  - 2. Demand-pull inflation and LRAS
  - 3. Cost-push inflation and LRAS
  - 4. Recession and LRAS
  - 5. Inflation vs. Unemployment: Phillips Curve
    - a. Short-run Phillips Curve
    - b. Long-run Phillips Curve
  - 6. Laffer Curve and Taxation

### III. UNIT THREE: *Money, Banking, and Monetary Policy* (Chapters 13-15, 2-3 weeks)

#### A. Chapter 13: *Money and Banking*

- 1. Functions of Money
  - a. Medium of exchange
  - b. Unit of account
  - c. Store of value
- 2. M1: Currency + Paper Money + Checking and Debit Accounts
- 3. M2: All of M1 + Savings + Small time deposits + Money market mutual funds
- 4. M3: All of M2 + large (over \$100,000) time deposits
- 5. Credit cards expenditures aren't money. They're loans.
- 6. As prices rise, value of money decreases
- 7. Demand for Money: Money-Market Graphs
  - a. Transaction demand - constant at all interest rates
  - b. Asset demand - varies inversely with interest rate
  - c. Total demand = transactional + asset
- 8. Money supply and interest rates
  - a. less money - high IR
  - b. more money - low IR
- 9. Loanable-funds markets
  - a. Interest rate affects investment
  - b. Relationship to money-market graph

#### B. Chapter 14: *How Banks and Thrifts Create Money*

1. Assets = Liabilities + Net Worth
2. Assets
  - a. cash on hand
  - b. property
  - c. reserves
  - d. securities
  - e. loans
3. Liabilities and Net Worth
  - a. Checkable deposits
  - b. capital stock
4. Reserve ratio
5. Excess reserves
6. Loans create money
7. Paying loans off destroys money
8. Monetary multiplier =  $1/(\text{reserve ratio})$
9. Full monetary multiplier assumes no leakages
10. Excess reserves \* monetary multiplier = total money created
11. Banks want profits
12. Banks need to keep liquid
13. Leakages

C. Chapter 15: *Monetary Policy*

1. Fed Assets
  - a. Securities
  - b. Loans to banks
2. Fed Liabilities and Net Worth
  - a. Commercial bank reserves
  - b. Treasury deposits
  - c. Federal Reserve Notes (outstanding)
3. Open-Market Operations
  - a. Buying securities from banks and public
  - b. Selling securities to banks and public
  - c. Effect on money supply
  - d. Effect on interest rate
  - e. Effect on investment and net exports
  - f. Effect on the National Debt
4. Adjusting the Reserve Ratio
5. Setting the discount rate (Federal Funds Rate)
6. Easy Money Policies
7. Tight Money Policies
8. Speed of monetary policy
9. Fed isolation from political pressure
10. Velocity of money - declines with lower interest rates
11. Monetary policy limitations

IV. UNIT FOUR: *International Economics and the World Economy* (Chapters 37-39, 1-3 weeks)

A. Chapter 37: *International Trade*

1. Key Facts
  2. Economic Basis for Trade
  3. Comparative Advantage
    - a. Determining comparative advantage
    - b. Determining beneficial terms of trade
    - c. Determining gains from trade
  4. Supply and Demand in Global Markets
  5. Trade Barriers
  6. Protectionism vs. Free Trade
- B. Chapter 38: *Exchange Rates, the Balance of Payments, and Trade Deficits*
1. Financing International Trade
  2. Balance of Payments
    - a. Current account
    - b. Capital account
    - c. Official reserves account
    - d. Deficits and surpluses
  3. Flexible Exchange Rates
    - a. Depreciation
    - b. Appreciation
    - c. Impact on trade
    - d. International Money-Market Graph
  4. Fixed Exchange Rates
  5. International Rate-Exchange Systems
    - a. Gold Standard
    - b. Bretton Woods
    - c. Managed Float
  6. US Trade Deficits