

## Study Guide #1: Introduction to Economics

**Mandatory Study Guide:** This review sheet is required of all students and is due the day before your unit Exam. Only review sheets which demonstrate considerable effort will be given credit.

See practice test questions on class website to check your understanding!

- 1) Write 2-3 sentences stating the “formal definition” of the study of **Economics**.  
 a. Words/phrases to use in definition: social science, unlimited wants & needs, scarce resources

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- 2) What exactly is “scarcity?” \_\_\_\_\_

- 3) What are the four categories of resources (also known as factors of production)?

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- 4) What is the concept of “opportunity cost?” \_\_\_\_\_

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- 5) How is the concept of a “tradeoff” related to the concept of opportunity cost? \_\_\_\_\_

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- 6) Explain why nothing is considered “free” in economics (think opportunity cost). Then provide a real world/life example.

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- 7) List the **4 primary** economic systems, provide an example of a country which uses each system, and identify an opportunity cost and opportunity benefit of each system.

System	Country	Opportunity Benefit of this system	Opportunity Cost of this system

- 8) Of the **4 economic goals** (GEES) explain why a **market economy** focuses on growth & efficiency: \_\_\_\_\_

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- 9) What were two key steps taken by President Boris Yeltsin to transition Russia from a command economy to a market economy? What were the effects of these steps? \_\_\_\_\_

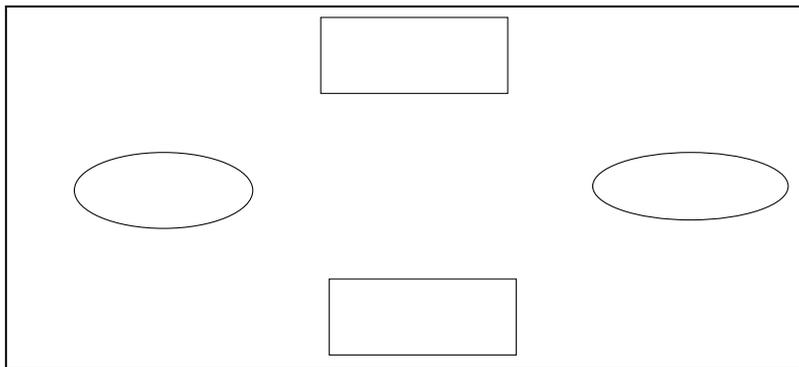
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10) Very precisely label all parts of the circular flow, including drawing in and labeling the arrows that describe the relationships involved.



b. Explain how rising unemployment would affect the circular flow of the economy from both the consumers' and producers' standpoints::

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11) **Circle** the correct answer;

- |                                |                                 |                                 |
|--------------------------------|---------------------------------|---------------------------------|
| a. Rising Interest rates would | increase speed of circular flow | decrease speed of circular flow |
| b. A terrorist attack would:   | increase speed of circular flow | decrease speed of circular flow |
| c. Rising Consumer Confidence: | increase speed of circular flow | decrease speed of circular flow |
| d. Rising Price of Oil:        | increase speed of circular flow | decrease speed of circular flow |

12) a. What does **Gross Domestic Product** (GDP) measure? \_\_\_\_\_

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b. What is the equation for calculating GDP? **GDP =** \_\_\_\_\_

c. What does each letter in the GDP equation stand for? \_\_\_\_\_

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d. Which component makes up the greatest percentage of GDP and what % is it? \_\_\_\_\_

13) Define "GDP Growth Rate." \_\_\_\_\_

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14) State the upper and lower "speed" limits (the preferred range) for the GDP growth rate and explain the reasons for both the upper & lower limits:

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15) Please **circle** the correct answer regarding the effect of the following events on **GDP**

- |                              |              |              |           |
|------------------------------|--------------|--------------|-----------|
| a. Exports Increase          | Increase GDP | Decrease GDP | No Effect |
| b. Business Investment falls | Increase GDP | Decrease GDP | No Effect |
| c. Government Spending rises | Increase GDP | Decrease GDP | No Effect |
| d. Imports Increase          | Increase GDP | Decrease GDP | No Effect |
| e. Consumption falls         | Increase GDP | Decrease GDP | No Effect |
| f. You buy a used Ford Car:  | Increase GDP | Decrease GDP | No Effect |

- 16) Please **circle** the correct answer regarding **Microeconomic** events versus **Macroeconomic** events:
- |                                |                     |                     |
|--------------------------------|---------------------|---------------------|
| a. Apple invents new I-pod     | Macroeconomic event | Microeconomic event |
| b. Interest rates Increase:    | Macroeconomic event | Microeconomic event |
| c. Unemployment Rate Falls     | Macroeconomic event | Microeconomic event |
| d. Rising Consumer Confidence: | Macroeconomic event | Microeconomic event |
| e. Auto workers go on strike:  | Macroeconomic event | Microeconomic event |

17) All decisions have both **short run** and **long run** consequences (benefits & costs). Give an example of a decision that will have a **positive** short run impact but a **negative** long run impact.

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18) What are Adam Smith's Two Laws of the Market? \_\_\_\_\_

19) Explain how **Adam Smith's** theory of the "**free market**" would solve a shortage of a good in the market place.  
 a. **Hint:** discuss the **invisible hand** & how the market "self-regulates"

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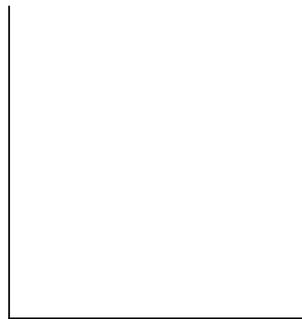


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20) Draw a **Production Possibilities Frontier {PPF}** for "**Country A**" that makes **food and shelter**. Label points on, above, and below the line with brief descriptions of what each point would mean



Explain VERY PRECISELY what the PPF line of a country represents: \_\_\_\_\_

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21) What is "human capital" and why is it important in shifting a country's PPF curve to the right? \_\_\_\_\_

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- 22) Please **circle** the correct answer regarding **PPF curves**:
- |                               |              |             |          |
|-------------------------------|--------------|-------------|----------|
| a. Country discovers more oil | Shifts right | shifts left | no shift |
| b. Unemployment rate rises    | Shifts right | shifts left | no shift |
| c. School systems improve     | Shifts right | shifts left | no shift |
| d. Advances in Technology     | Shifts right | shifts left | no shift |

- 23) Draw the **Business Cycle**.
- label each section of the business cycle with the appropriate economic term identifying that portion of the cycle

GDP

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Time

What is happening to inflation and unemployment during

- a) the expansionary phase of the business cycle? \_\_\_\_\_
- b) the contractionary phase of the business cycle \_\_\_\_\_

24) What is the official definition of a recession? \_\_\_\_\_

25) If you borrowed \$1000 from a bank, the bank charged you 10% interest, and you paid the bank \$200 this year, how much would you owe the bank at the end of the year? \_\_\_\_\_

26) What exactly is an interest rate? \_\_\_\_\_

27) What will be the effect of falling interest rates? Rising interest rates? Why? \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

28) Define "Unemployment Rate": \_\_\_\_\_

29) What is "Full Employment?" Why do we consider an unemployment rate higher than 0% to be "full employment?" \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

30) Define "Federal Funds Rate": \_\_\_\_\_

\_\_\_\_\_

31) Define "Inflation Rate": \_\_\_\_\_

32) What is the CPI and how is it related to the inflation rate? \_\_\_\_\_

\_\_\_\_\_

33) What is the inflation rate preferred by economists? Why? \_\_\_\_\_

34) Define "Jobs Growth Number": \_\_\_\_\_

35) How many new jobs must the U.S. economy create monthly to keep up with new entrants into the work force? \_\_\_\_\_

36) What are the most recent statistics for each of the following Economic Indicators:

a. Current Unemployt Rate: \_\_\_\_\_

b. Current FFR: \_\_\_\_\_

c. GDP Growth Rate: \_\_\_\_\_

d. Most Recent Jobs Number: \_\_\_\_\_

37) Describe how Government **incentives** alter the behavior of consumers and/or producers.

a. Hint: think taxes and subsidies (the opposite of taxes) and how they alter opportunity costs and benefits

38) Given the following sets of economic indicators, analyze what the health of the economy is like at that moment. In each scenario, if you were head of the Federal Reserve, what action would you take with the Federal Funds Rate (increase it, lower it, take no action/keep it the same).

a.	GDP Growth Rate	-1.2%	GDP growth rate is	TOO FAST	TOO SLOW	ACCEPTABLE RANGE
	Inflation Rate	0.1%	Inflation rate is	TOO FAST	TOO SLOW	ACCEPTABLE RANGE
	Unemployment Rate	11.2%	Unemployment rate	TOO LOW	TOO HIGH	ACCEPTABLE RANGE
	What action would you take with the Federal Funds Rate?			INCREASE IT	LOWER IT	TAKE NO ACTION

b.	GDP Growth Rate	3.1%	GDP growth rate is	TOO FAST	TOO SLOW	ACCEPTABLE RANGE
	Inflation Rate	4.9%	Inflation rate is	TOO FAST	TOO SLOW	ACCEPTABLE RANGE
	Unemployment Rate	3.9%	Unemployment rate	TOO LOW	TOO HIGH	ACCEPTABLE RANGE
	What action would you take with the Federal Funds Rate?			INCREASE IT	LOWER IT	TAKE NO ACTION

c.	GDP Growth Rate	3.2%	GDP growth rate is	TOO FAST	TOO SLOW	ACCEPTABLE RANGE
	Inflation Rate	2.3%	Inflation rate is	TOO FAST	TOO SLOW	ACCEPTABLE RANGE
	Unemployment Rate	5.6%	Unemployment rate	TOO LOW	TOO HIGH	ACCEPTABLE RANGE
	What action would you take with the Federal Funds Rate?			INCREASE IT	LOWER IT	TAKE NO ACTION

39) Based on just the following economic indicators (not on political conditions), give a grade for the overall economic health of each country, including your justifications for that grade:

Economic Indicator	Country A	Country B	Country C
Developed or Developing Country	Developing	Developed	Developed
Real GDP Growth Rate, last 4 quarters	+6.2%, +6.0%, +5.8%, +5.2%	+1.2%, +0.3%, +1.5%, +1.2%	+2.3%, +1.9%, +2.4%, +2.6%
Inflation Rate	4.2%	1.4%	2.2%
Unemployment Rate	4.5%	9.1%	5.2%
Consumer Confidence Index (0-100 scale)	62	70	45
<b>GRADE FOR OVERALL ECONOMIC HEALTH &amp; JUSTIFICATION FOR THAT GRADE</b>			

**Free Response Short Answer/Essay Preparation**

1. Be prepared to very precisely label all parts of the circular flow diagram, including drawing in and labeling the arrows that describe the relationships involved. Be prepared to analyze and describe in writing how GDP, Unemployment, Inflation, and Interest Rates are related to the circular flow of our economy.
2. Be able to explain in writing Adam Smith's theory of the self-regulating free market with specific reference to his Two Laws of the Market. Be able to explain in writing how the free market "corrects" for a shortage of a particular product.
3. Be able to explain in writing exactly what the Production Possibilities Frontier (PPF) Curve represents. As well, be able to discuss the various ways that a nation can shift its PPF curve to the right in the long run.