Wilfrid W. Csaplar Jr. Review Sheet for Exam 1 & the non-graded laboratory #5A. Economics 350

This review sheet is intended to cover everything that could be on the exam. However, it is possible that I may have inadvertently overlooked something. You are still responsible for everything in the chapters covered except anything that I explicitly say you are not responsible for. Therefore, if I left something off of this sheet, it can still be on the exam. There will be no multiple-choice questions. Most of the questions will be like the ones on the homework assignments, and possibly a few definition questions. I am more likely to ask questions that make you use definitions rather than have you recite them.

The optional review session for this test will be Tuesday 10/14 at a time yet to be announced.

Chapter 4: What are natural rate of unemployment, a.k.a. full employment, and labor force participation rate? How are the CPI and PPI calculated? In general, what is the difference between M1, M2, M3, and L? Explain why we care about more than one of them. Be able to calculate the real interest rate from the nominal rate using the accurate method and using the estimate. Know why the accurate method is more accurate. Ignore consumer installment credit and futures. Know the definitions of the Dow Jones Index and the S & P 500 Index. Know who gets hurt and who gets helped by appreciation and depreciation of the currency. For residential construction, average workweek, and new orders, know why economists monitor them.

Chapter 5: For the different schools of thought, know in general what they think. Know why MV = PY is important. (Note that I changed Q to Y because normally Q represents the quantity of a particular good and Y is GDP. That is a new standard, but the theories originally used Q.) Note that they have described monetarism slightly wrong. They described the most recent version of neo-classical in that section. Monetarists feel that there are some lags in effects of events, but not long like Keynesians. Since the lags will mean that the effects of the policies will happen so much later that they could have an undesirable affect. Know what are endogenous and exogenous variables. Be able to calculate a reduced form and use that to calculate the multipliers. Be able to also show the model on the 45° diagram. Understand why each variable takes the functional form that it takes. For understanding what the different parameters mean, it is helpful to remember that the subscripts correspond to the equation number. They are numbered C = 1, I = 2, G = 3, X-M = 4, M_d = 5, which is the order from Y = C+I+G+X-M. The αs are autonomous constants. The βs are sensitivity of that variable to GDP, which is usually the marginal propensity to do whatever the variable says. The γs are the sensitivity of the variable to interest rates. Since the βs show how much a variable changes when GDP changes, they will affect both the slope of the E= C+I+G+X-M line on the 45° diagram and the autonomous expenditure multiplier. Use the equations from the goods and services market to derive the IS curve and the $M_s = M_d$ equations to derive the LM curve. What is the principle of acceleration? Understand why the IS and LM curves slope as we drew them, and when they are flat or steep. Hint: The IS curve slopes down because a drop in R causes an increase in I, and that causes Y to increase. Anything that affects the relative size of the change in I or Y will change the slope. A bigger ΔY will cause a flatter curve. What moves the IS and LM curves? For which slopes of the IS and LM curves, is monetary policy effective and when is it ineffective? Why? For which shapes of the IS and LM curves, is fiscal policy effective and when is it ineffective? Why? Ignore section 5.III.D.

Chapter 6: The early parts of this chapter are incomprehensible to most people and are unimportant for this course. What you need to know from this chapter is how to run a regression in Excel. That is what we did in many labs. Understand how to interpret your results, and detect possible problems with the data. Section 6.VI is helpful for the latter. Be able to test, and if necessary correct for multicollinearity, heteroscedasticity, and autocorrelation.

Wilf Csaplar Jr. Economics 350 Laboratory #5A To be covered on 10/13
This is a non-graded laboratory assignment that will be gone over the same class we go over assignment #5. The purpose of this assignment is to give you sample questions for the material we covered after you handed in laboratory #5, and will be on the exam.

1A) (20 points) Suppose that investment is sensitive to interest rates, but money demand is insensitive to interest rates. Draw the IS/LM diagram that corresponds to those statements. Explain why the curves take those shapes.
1B) (20 points) Use the diagram in part A to determine whether monetary or fiscal policy will be more effective. Draw both policies on the diagram and explain the logic as to why one policy will work well while the other won't.

2) (30 points) The Japanese economy is currently in a liquidity trap. This means the interest rates are so low that money demand is very sensitive to interest rates. Draw the IS/LM diagram that corresponds to this situation. Why is this a problem for expansionary monetary policy?

3) (30 points) Having a large autonomous expenditure multiplier can both help and hurt the effectiveness of fiscal policy. Draw the IS/LM diagram that corresponds to this situation. Explain both why the large multiplier helps the effectiveness of fiscal policy and hurts its effectiveness.