This review sheet is intended to cover everything that could be on the exam; however, it is possible that I will have accidentally left something off. 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 in the homework assignments, and possibly a few definition questions, but I am more likely to ask questions that make you use the definitions rather than recite them. I will probably ask one of the questions from the book at the end of the chapters.

The review session will announced, probably Thursday, 10/6, in the normal computer lab.

For the laboratories, you will be expected to be able to calculate a Laspeyres Price Index or a Paasche Price Index with any base year and the resulting inflation. You should also be able to do the simple forecasts similar to those in Lab #4. That would be the *same value, same change, same percent change, n-period moving average,* and *n-period weighted moving average.* You should also know what the advantages and disadvantages of each of these methods are. What patterns do they give for the plots over time.

In general, for both chapters, you may be asked to show the effects upon the IS/LM/FE diagram, NS/ND diagram, and/or the SRAS/LRAS/AD diagram. For the SRAS, generally, draw it upward-sloping, especially with the *Misperceptions Theory*. However, in the Keynesian school, you can draw it flat.

Chapter 10: This chapter is about the *Classical School* and the *Neo-classical School's* improvements to the theories. Understand the *Real Business Cycle* theory of how real shocks and nominal shocks affect the economy in the *Classical Model*. What are the conclusions of the model? How do they fit the normal business cycle and how do they differ? Are productivity shocks the only source of business recessions? What is the Solow residual? What would explain labor hoarding? What are the short and long-run effects of fiscal policy? Use diagrams to answer the question. Should fiscal policy be used to dampen the cycles? What is meant by neutrality of money and why might there be a reverse causation between future changes of GDP and the current money supply? Why might money be non-neutral? How does the *Neo-classical*, a.k.a., *Rational Expectations* school use the *Misperceptions Theory* to explain how money may have real effects if it is not perceived correctly? Understand why $Y = Y_{FE} + b(P - P^e)$ should hold. Be able to illustrate the effects on the diagrams.

Chapter 11: What is meant by real-wage rigidity and nominal wage rigidity? Which one is the important one? Be able to explain it with the following explanations, and be able to explain the problems with them. How does the high wage reduce turnover and/or increase efficiency? Why does the effort curve take that shape and why do you want the point of tangency? How does the efficiency wage cause high unemployment? What does it do to the FE line? How do menu costs and imperfect competition cause high sticky prices? For the latter, we mentioned that the firms will not lose all of their customers if they do not respond to the market, the possible assumption that their competitors may only meeting price decreases, and fixed markup. For the latter, explain why a fixed markup may make economic sense. Ignore the effective labor demand curve because it is just an inverted production function. How do monetary and fiscal policies affect the diagrams? For the explanation of the IS curve movements, you can use the ones in the book, but the comparing it to the AD diagram is mathematically equivalent and easier to understand, especially in this chapter. What causes the business cycle in the Neo-Keynesian view? Why might this require government intervention? What is the liquidity trap and why does that mean monetary policy cannot work? How do supply shocks affect the economy?

This is the non-graded Assignment #4A that will be reviewed with Assignment #4.

1) (10 points) Why should $Y = Y_{FE} + b(P - P^e)$?

2) (40 points) Use the SRAS/LRAS/AD diagram for the Neo-Keynesian model and the IS/LM/FE diagram to illustrate an increase in the money supply. Explain why the curves moved as drawn. What happens to GDP, inflation, and interest rates? Is there neutrality of money? Explain your logic.

3) (20 points) Use the IS/LM diagram to explain why some Keynesian economists conclude that monetary policy won't work.

4) (10 points each) Explain BOTH the explanation that firms match competitors price decreases but not increases, AND fixed markups BOTH cause price rigidities.