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 Tuesday, 3/15, in the normal computer lab.
Note that these labs and Chapter 12 were on Exam #3 in the past

For the laboratories, be able to run regressions. Understand what *Adjusted R², Significance of F, coefficient, T-statistic, P-value, upper* and *lower 95%* mean. What are good values for those numbers? Be able to know when to eliminate a variable from a regression based upon those statistics. Know how to run a regression based on time. Be able to use those results to write an equation which will predict your *Y* variable. Be able to check for **multi-colinearity** using the correlation coefficients with a cutoff of 0.80, check for **auto-correlation** and **heteroscedasticity** using the residual plots. For the former two, be able to do the simple corrections of eliminating a variable and using a squared term or ln respectively. *Note that if you use ln, you must do <u>ln for all variables</u>*. Know the formal test for heteroscedasticity using the **F-distribution**.

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 $Y = \bar{Y} + b(P - P^e)$ 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.

Chapter 12: Understand the theory using the LRAS/SRAS/AD diagram which would result in a nice **Short-Run Phillips Curve (SRPC)**. Understand what moves the **Augmented SRPC** and the **LRPC**. <u>Note that the intersection point is only the point where we will be if we are at full employment.</u> Therefore, if we do not have $\pi = \pi^e$, then the economy will not be at that point. The point the economy is at depends upon the relationship between π and π^e. What are the costs of unemployment? Understand

both the *cultural* **and the** *hysteresis* explanations of what determines the natural rate of unemployment, a.k.a. the unemployment rate at full employment. The latter is the *insider-outsider model*. What can be done to reduce the natural rate of unemployment? What are the problems with **anticipated inflation, unanticipated inflation**, and **hyperinflation**? How can inflation be fought? What are the advantages and disadvantages of **cold turkey** versus **gradualism**? Why aren't **wage and price controls** a good idea? How can *tax-based income policies* **(TIP)** help reduce inflation? Why might they make the problem worse?

This is the non-graded Assignment #5A that will be reviewed with Assignment #5.

1) (15 points) Go to https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm . There was a huge increase in the unemployment rate in March of 2020. Do you think that hysteresis would cause the unemployment rate at full employment to increase because of that? If yes, explain why. If no, then explain why not. Either way, make sure you explain hysteresis. Below the chart is a button to show the table. You may want to do that and look at the two years starting in March of 2020.

2) (15 points) In the 1970s, many women entered the labor force. What happened to the natural rate of unemployment? Explain your logic.

3) (15 points) According to https://tradingeconomics.com/country-list/inflation-rate?continent=world, the inflation rate in Venezuela is 472% (down from 686%). Do you think they should use a cold turkey or gradual approach to fighting inflation? Explain your logic.

4) (15 points) According to https://tradingeconomics.com/country-list/inflation-rate?continent=world, the inflation rate in Canada is 5.1%. Do you think they should use a cold turkey or gradual approach to fighting inflation? Explain your logic.

5) (15 points) What is one way to decrease the natural rate of unemployment which you think is a good idea? Explain how that would work and why it is good.

6) (15 points) What is one way to decrease the natural rate of unemployment which you think is a bad idea? Explain how that would work and why it is bad.

7) (10 points) How would TIP reduce the inflation rate?