AD/AS Lab

WITSOOTH · CLEVER TRUTH

Name ____________________ Period ________

DRIVING QUESTION

If a shock knocks the economy off balance, does it fix itself — and if so, what actually does the fixing, and how long does it take?

Gut instinct now. Answer it again at the end using the self-correction mechanism.

BEFORE THE GAME

Adam Smith called it the "invisible hand" — markets wobble but always find their way back to balance on their own, no policy required. Sounds tidy. Is it true, and what's doing the pushing?

Your gut answer — if a recession hits with zero government response, does the economy eventually heal on its own? Why or why not?

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Quick prediction — if the economy does self-correct, is it fast (weeks) or slow (years)?

☐ Fast ☐ Slow ☐ Depends

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CONCEPTS TO WATCH FOR

CONCEPT 1

Recessionary Gap

Actual output sits below potential GDP, unemployment is high. Self-correction requires wages to fall — slow and painful, because workers resist pay cuts.

CONCEPT 2

Inflationary Gap

Actual output sits above potential GDP — an overheated economy. Self-correction requires wages to rise as workers demand more, which happens faster.

CONCEPT 3

Self-Correction

The classical chain: gap opens → the labor market reacts → wages adjust → per-unit production costs shift → SRAS moves back until the economy returns to potential GDP, Yf.

DURING THE GAME — DIAGNOSE & HEAL

ROUND	SHOCK (DEMAND OR SUPPLY)	GAP DIAGNOSED	WAGE DIAL MOVED	HEALED?
1	____________	☐ Recess. ☐ Inflat. ☐ None	☐ Up ☐ Down	☐ Yes ☐ No
2	____________	☐ Recess. ☐ Inflat. ☐ None	☐ Up ☐ Down	☐ Yes ☐ No
3	____________	☐ Recess. ☐ Inflat. ☐ None	☐ Up ☐ Down	☐ Yes ☐ No
4	____________	☐ Recess. ☐ Inflat. ☐ None	☐ Up ☐ Down	☐ Yes ☐ No
5	____________	☐ Recess. ☐ Inflat. ☐ None	☐ Up ☐ Down	☐ Yes ☐ No

Log any 5 rounds from Act II (Demand Experiments) or Act III (Supply Experiments) — mix both if you can.

AFTER THE GAME

Compare a recessionary-gap round to an inflationary-gap round. Which direction did the wage dial need to move for each — and which one took longer to heal?

Now use the vocabulary: sticky wages means wages resist moving in one direction more than the other. Which direction is "sticky," and why does that make recessions linger longer than booms?

TRANSFER — SAME MECHANISM, REAL WORLD

"Minimum Wage Laws Keep Wages From Falling in a Recession"

A city hits a deep recession — a recessionary gap opens, unemployment climbs. Classical theory says wages should fall until the labor market clears and the gap closes on its own. But a wage floor (minimum wage law) makes it illegal for wages to fall below a set level, however weak the job market gets.

A. What is the wage floor actually blocking here — which step of the self-correction chain gets stuck?

B. Without wages falling, does SRAS ever shift back to close the gap on its own? What has to happen instead?

C. Connect it to the game — which round felt like this, where the "healing" lever got harder to move?

RETURN TO THE DRIVING QUESTION

If a shock knocks the economy off balance, does it fix itself — and if so, what actually does the fixing, and how long does it take?

Use the self-correction chain and the sticky-wages idea in your final answer.