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## APPENDIX I

### Experimental Instructions (translated from Spanish)

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The purpose of this experiment is to study how individuals make decisions in certain contexts. The instructions are simple and, if you follow them carefully, you can directly earn final marks at the end of the experiment. The final amount of marks will be showed in a confidentially way, no one will know the payments received by the other participants. If you have any question, please raise first your hand. Out of these questions, any communication between you is forbidden and subject to the immediate exclusion of the experiment.

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- 1) This experiment consists of 25 rounds. In each round, you make decisions individually, there is no interaction among participants.
- 2) In each round, you will make decisions as a government that makes a series of economic policy decisions. Although your decisions include both fiscal and monetary policy measures, and for simplicity, we will summarize those decisions on the impact they will have on the inflation rate of the economy. In this way, we will assume that you directly choose the inflation rate in the economy in each period. Your decisions in terms of inflation must be greater than 0 and less than 50 (for convenience).
- 3) What do you know about the functioning of the economy? As usual in this type of experiments, you have no information about the underlying macroeconomic conditions. You will understand the conditions once you start to make decisions, observing the reactions of the economy (expressed in the unemployment rate) from your economic policy decisions (summarized in the inflation rate).
- 4) At the beginning of the experiment, the only thing you know is that the conditions of the economy do not change over time, which means that the macroeconomic results depend on your decisions (in that round and in past rounds) and also depend on the economic disturbances.
- 5) In each round, the levels of inflation and unemployment generate a certain support level of your management by citizens. We will summarize this support level in an index of political support that depends exclusively on how the citizens of the country are affected by (i) inflation (which you choose) and (ii) unemployment (which is determined by the reaction of the economy to your economic policy decisions, as we have described above). Index values range from 0 to 100.

- 6) Your citizens do not like inflation or unemployment, but what you do not know (at the beginning of the experiment) is how their support is affected by specific combinations of both variables (inflation and unemployment). The relative weights of inflation and unemployment in the citizen support will not vary throughout the experiment.
- 7) At the end of each round you will receive information about your current and past decisions (inflation), the unemployment rate in your economy, the index of citizen support and the average decision of all participants in this session (the average inflation of the experiment), which does not affect your benefits.
- 8) The reward (final marks) you obtain in the experiment depends exclusively on the support accumulated by your citizens in the odd periods after 6 (7-9-11-13-15-17-19-21-23-25). Your results in the rest of the rounds do not count. At the end of the practice the participant with the highest (minor) accumulated support will obtain 0.20 (0.00) points of note, and the rest a note proportional to the distance (between the best and the worst performance).

## APPENDIX II

### Exam question about Phillips Curve (translated from Spanish)

In Question 3. (3 points)

Consider the following information for an economy:

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|-----------------------|----------------------------------|
| (1) Phillips Curve:   | $\Pi_t = \Pi_t^e - a(u_t - u_n)$ |
| (2) Okun's Law:       | $u_t - u_{t-1} = -1(g_{yt} - 3)$ |
| (3) Aggregate Demand: | $g_{Mt} = \pi_t + g_{yt}$        |

- a) Which kind of behavior represents the Phillips curve? Define the natural rate of unemployment and the sacrifice ratio.
- b) Suppose that  $u_n=8\%$ ;  $a=0.7$  and  $p^e=3\%$ . Represent graphically the Phillips Curve indicating the breakpoints in the axis x and y. Which effect can we observe in the curve if the value of  $a$  increases to 0.8? What is the economic interpretation?
- c) Graph the price equation and the wage equation. Suppose that the economy increases the competition. Indicate whether this change affects the equations and the natural rate of unemployment. Explain them with details.
- d) Suppose that in period  $t$  the economy is on equilibrium in the medium term, with  $a=0.7$ ;  $g_M=8\%$ ;  $u_n=8\%$ . Indicate the equilibrium values of inflation, the rate of income growth and the unemployment rate.
- e) From the situation described in d), and assuming that  $\pi_t^e = \pi_{t-1}$ , consider that the Central Bank implements a monetary policy to reduce inflation by two points (at the rate of one per year). Describe the growth rate of money needed to get it, the rate of inflation, unemployment and the economic growth in the next two periods ( $t+1$  and  $t+2$ ).
- f) Suppose now that in period  $t$  a new chief of the Central Bank with a tough anti-inflationist reputation is elected and he proposes  $\pi_t^e = 0.8 \pi_{t-1}$ . According to this new situation, follow the exercise proposed in e) obtaining the new results in  $t+1$  and  $t+2$ . Finally, compare them with previous ones. ■