Chapter 14

1. Let LF equal the labor force, E the employed, and U the unemployed. The unemployment rate equals:
   a) E– U
   b) U/LF
   c) E/LF
   d) E/U

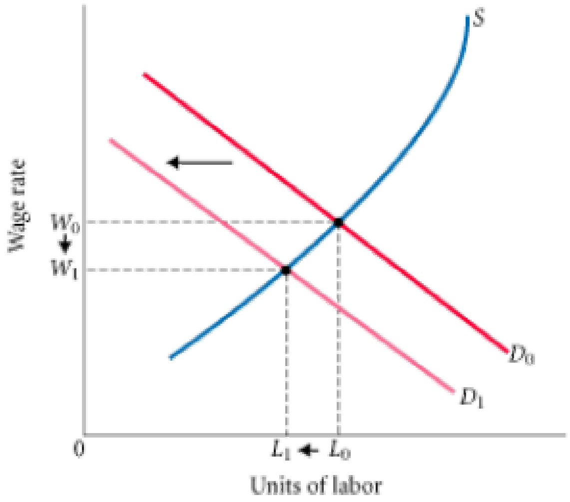
2. Cyclical unemployment can best be described as
   a) The unemployment that exists because old industries disappear to create new ones, and the workers in the old industries don't have the required skills to work in the new industries.
   b) The increase in unemployment that occurs during recessions and depressions.
   c) The unemployment associated with workers' lack of skills for the available jobs.
   d) The unemployment when the economy is in a boom.

3. Structural unemployment occurs when
   a) The economy suffers from a recession.
   b) Changes in the economy result in a significant loss of jobs in certain industries.
   c) Someone just became unemployed and is looking for work, but has an absolute certainty of finding work soon.
   d) Inflation rises.

4. The classical view of the unemployment market is consistent with the following idea:
   a) There should be no persistent unemployment above the frictional and structural amount.
   b) At the equilibrium wage rate, everyone who wants a job can have one.
   c) A decline in the demand for labor does not necessarily mean that the unemployment rate will rise.
   d) All of the above.

5. The classical view of the unemployment market is consistent with the following idea:
   a) The amount of labor that a firm hires depends on the value of the output that workers produce.
   b) The wage rate adjusts to equate the quantity of labor demanded with the quantity of labor supplied; therefore, persistent unemployment above the frictional and structural amount is unlikely.
   c) If the wage rate in the labor market is too low, people will work for themselves.
   d) All of the above.

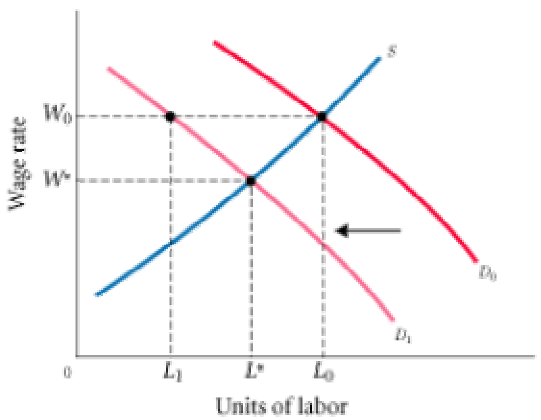
6. Refer to the figure below. According to Classical economists, what is the impact of the decrease in labor demand?



a) The decrease in demand causes a decrease in the quantity of labor supplied.
b) The unemployment rate at L1 is greater than it was at L0.
c) The decrease in the wage rate necessary to achieve a new equilibrium is unlikely to occur.
d) All of the above.

7. The classical view of the labor market is consistent with the view that:
a) Wages are sticky; that is, they don’t adjust quickly to price changes.
b) Monetary policy can have a significant effect on the level of output and employment.
c) The aggregate supply curve is vertical.
d) All of the above.

8. Refer to the graph below. The meaning of “sticky wages” in this graph refers to:



a) The decrease in the equilibrium wage that results after the decrease in demand.
b) The failure of the wage rate to fall after the decrease in demand.
c) The tendency for the wage rate to rise above W0 after the decrease in demand.

d) The decrease in unemployment that results after the decrease in demand.

9. Why are wages sticky, or exhibit downward rigidity?

a) Because there are unspoken agreements between workers and firms that discourage firms from cutting wages.
b) Because firms and workers enter into explicit contracts that stipulate workers' wages.
c) Because workers may be unwilling to accept wage cuts unless they know that other workers are receiving similar cuts.
d) All of the above.

10. One explanation for unemployment is that workers may be unwilling to accept a wage cut unless they know that workers in other industries are receiving similar cuts. This explanation is called:

a) The relative-wage explanation of unemployment.
b) The efficiency wage theory.
c) The social, or implicit, contracts explanation of unemployment.
d) The cross-industry wage explanation of unemployment.

11. Contract provisions that tie wages to changes in the cost of living are called:

a) Cost-of-living adjustments (COLAs).
b) Minimum wage laws.
c) Efficiency wages.
d) Explicit contracts.

12. An explanation for unemployment that holds that the productivity of workers increases with the wage rate is called:

a) Efficiency wages.
b) Minimum wage laws.
c) Cost-of-living adjustments (COLAs).
d) Explicit contracts.

13. The efficiency wage is among the theories of unemployment that explain why:

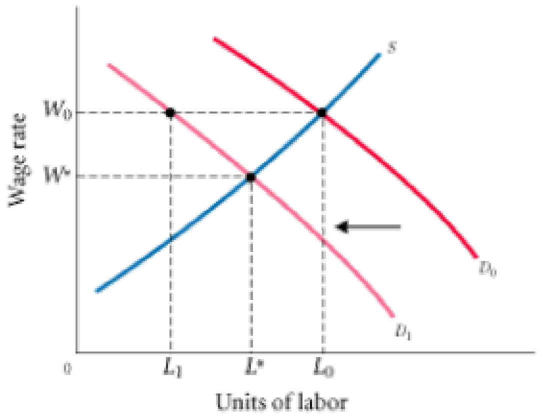
a) Firms tend to pay wages above the wage at which the quantity of labor demanded equals the quantity supplied.
b) Firms prefer to pay the wage at which quantity supplied equals quantity demanded in the labor market.
c) There is only one level of the wage rate at which quantity supplied equals quantity demanded, called the efficiency wage rate.
d) Firms tend to pay wages below the wage at which the quantity of labor demanded equals the quantity supplied.

14. If firms don't have enough information at their disposal to know what the market-clearing wage is., they may simply set wages wrong. Which explanation of unemployment follows this argument?

a) The relative-wage explanation.

b) The efficiency wage theory.
c) Social, or implicit, contracts.
d) Imperfect information.

15. Refer to the figure below. What happens in this labor market if the minimum wage (W0) is abolished?



a) The quantity of labor supplied rises.
b) Unemployment will fall.
c) The quantity of labor demanded falls.
d) Unemployment will rise.

16. Which of the following relationships is correct?
a) There is a negative relationship between output and employment.
b) There is a negative relationship between output and the overall price level.
c) There is a positive relationship between unemployment and output.
d) There is a negative relationship between the unemployment rate and the price level.

17. How are firms likely to respond to an increase in aggregate demand when the economy is operating at low levels of output?
a) There will be an increase in output with little or no increase in the overall price level.
b) There will be an increase in output and probably a decrease in the overall price level.
c) There will be little increase in output and probably a substantial increase in the overall price level.
d) There will be a decrease in output as well as a decrease in the overall price level.

18. The Phillips Curve shows a relationship between:
a) Unemployment and output.
b) Output and employment.
c) Output and inflation.
d) Unemployment and inflation.

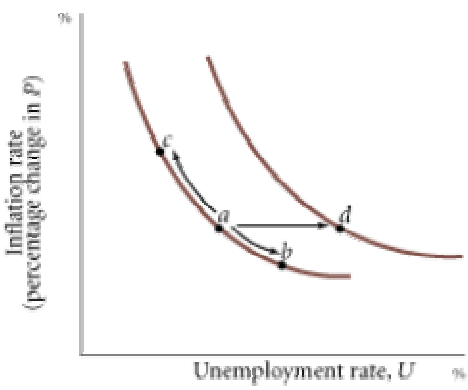
19. Policy discussions in the 1960s concerning the Phillips Curve revolved around the issue of:
  a) What point to choose along a smooth Phillips Curve.
  b) How to maintain low inflation and at the same time lower the unemployment rate.
  c) How to maintain low unemployment and at the same time lower the inflation rate.
  d) What to do about a highly unstable Phillips Curve.

20. If there is no systematic relationship between inflation and unemployment, it is because:
  a) Government policies have effectively eradicated inflation and unemployment.
  b) Both the aggregate demand and the aggregate supply curve shift simultaneously.
  c) Neither the aggregate demand nor the aggregate supply curves shift.
  d) The aggregate demand curve shifts, without a shift in the aggregate supply curve.

21. Among the reasons why the Phillips Curve was not stable in the 1970 is that:
  a) Inflationary expectations decreased considerably.
  b) The main variation in the 1970s was in aggregate demand.
  c) The price of imports increased considerably in the 1970s.
  d) All of the above.
  e)

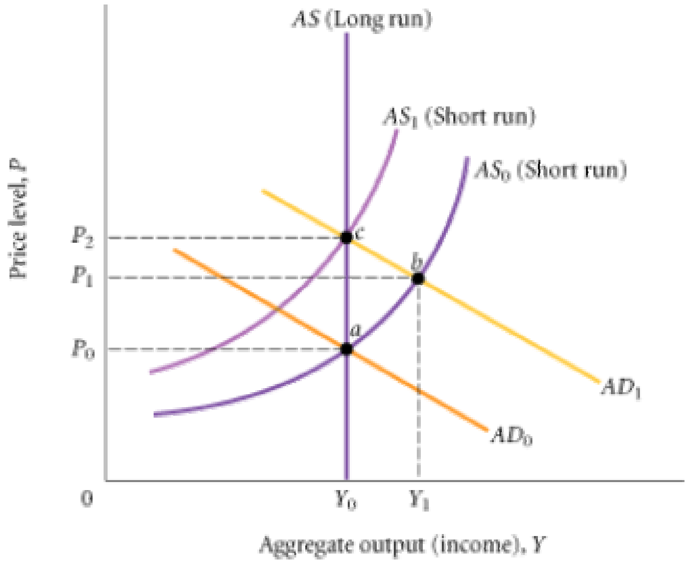
22. When we say that inflationary expectations are self-fulfilling, we mean that:
  a) Price expectations that affect wage contracts eventually affect prices themselves.
  b) Wage inflation is affected only by actual inflation, not by expectations of future price inflation.
  c) Inflationary expectations cause the relationship between unemployment and inflation to be positive rather than negative.
  d) If inflation is expected to be high in the future, negotiated wages are likely to decrease.

23. Refer to the graph below. The impact of higher inflationary expectations on this Phillips curve is reflected by the move:



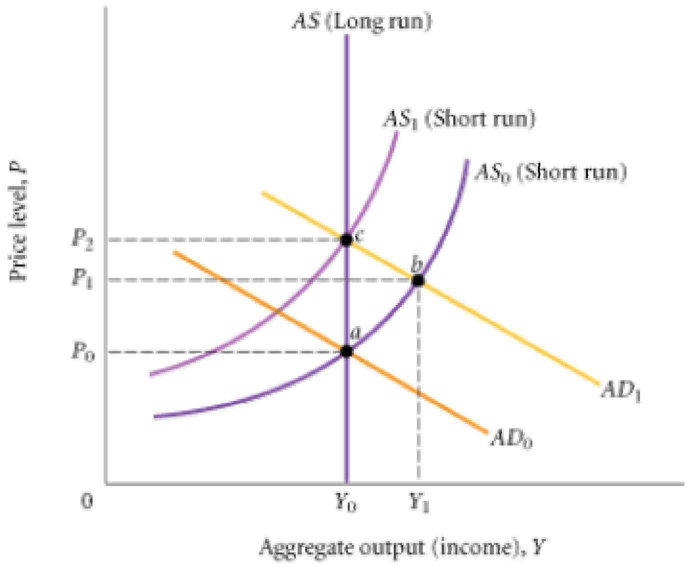
  a) From a to c.
  b) From a to b.
  c) From a to d.
  d) None of the above. Inflationary expectations do not affect the Phillips curve.

24. Refer to the graph below. When the economy is at point b,



a) Input prices are ahead of changes in the overall price level.
b) Input prices catch up almost immediately after a change in output prices.
c) Input prices lag behind changes in the overall price level.
d) Input prices are likely to decrease.

25. Refer to the graph below. What do points a and c have in common?



a) At both points, there is no upward or downward pressure on prices and wages.
b) At both points, the unemployment rate is the same—the natural rate of unemployment.
c) At both points, actual and expected prices and wages are equal.
d) All of the above.

26. The natural rate of unemployment is:
   a) The unemployment that occurs as a normal part of the functioning of the economy.
   b) The unemployment rate associated with a vertical long-run AS curve.
   c) The sum of frictional and structural unemployment.
   d) All of the above.

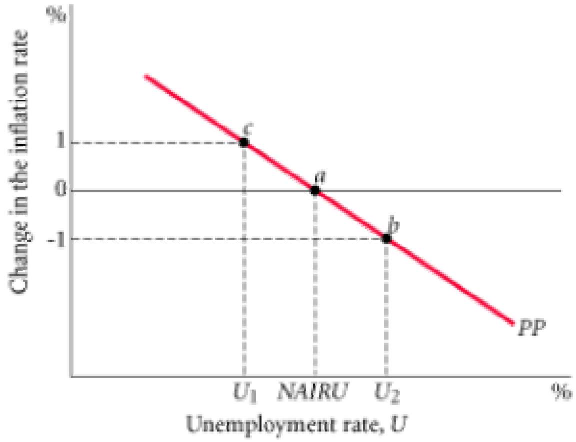
27. Refer to the figure below. When the economy is at point c in the NAIRU diagram below:

   a) The price level is decelerating, and the unemployment rate is increasing.
   b) The price level is changing at a constant rate.
   c) The price level is accelerating and the unemployment rate is decreasing.
   d) The price level is decelerating and the unemployment rate is increasing.

28. Refer to the figure below. Which of the following causes a leftward shift in the PP curve?

   a) A negative change in the rate of inflation.
   b) An adverse change in input prices.
   c) A positive change in the rate of inflation.
   d) A favorable change in input prices.

29. Refer to the figure below. What is the impact of increased foreign competition on the PP curve?



a) A shift of the PP curve to the left.
b) A northwest move along the PP curve.
c) A shift of the PP curve to the right.
d) A southeast move along the PP curve.

30. Refer to the figure below. Which of the following statements concerning the NAIRU equilibrium is correct?

a) When the economy is at point a, the inflation rate equals zero.
b) After 1995, the value of the NAIRU in the United States has been adjusted upward.
c) Before 1995, the value of the NAIRU at point a in the United States was around 6%.
d) Adverse shifts in the PP curve have resulted in an upward revision of the NAIRU estimate for the United States.

31. Cyclical unemployment is unemployment that arises during recessions in the economy.
a) True
b) False

32. A decline in the demand for labor necessarily causes the unemployment rate to rise.
  a) True
  b) False

33. In general, employment tends to fall when aggregate output falls and rise when aggregate output rises.
  a) True
  b) False

34. Classical economists believe that there is always an amount of unemployment beyond the structural and frictional amounts that is unavoidable.
  a) True
  b) False

35. If the equilibrium wage rate falls but wages are prevented from falling also, the result is unemployment.
  a) True
  b) False

36. Sometimes firms have incentives to pay wages above the wage at which the quantity of labor supplied is equal to the quantity of labor demanded.
  a) True
  b) False

37. The purpose of minimum wage laws is to eliminate unemployment.
  a) True
  b) False

38. The relationship between the unemployment rate and the price level is positive. An increase in the price level is consistent with a higher rate of unemployment, and vice versa.
  a) True
  b) False

39. The Phillips curve represents the relationship between the inflation rate and the unemployment rate.
  a) True
  b) False

40. Those who believe the AS curve is vertical in the long run also believe the Phillips curve is vertical in the long run at the natural rate of unemployment.
  a) True
  b) False

41. Describe the classical view of the labor market and unemployment, and provide three reasons why some economists don't subscribe to this view.

42. In the short run, the relationship between inflation and the unemployment rate is negative. Explain.

43. Explain the difference between the short-run Phillips curve and the long-run Phillips curve.

44. Describe and briefly explain the NAIRU.