

I. T/F/U (Explain your answer)

1. If prices are fully flexible and quantities are fixed, contractionary monetary policy can be used to fight inflation.
2. During periods of high unemployment, the probability of losing one's job increases, but so does the probability of finding a job if unemployed.
3. In any given month, almost all of those entering the labor force are new entrants, and almost all of those leaving are retiring.
4. If the unemployment rate remains a constant 7% for one year, it means that 7% of the labor force has remained permanently unemployed for the entire year.
5. Since all firms are profit maximizers, they will always pay the lowest wage necessary to attract the number of workers they need.
6. If discouraged workers were counted as part of the unemployment pool, the unemployment rate would be lower.
7. Non-unionized workers do not have any bargaining power.
8. Higher minimum wages can help reduce unemployment, especially among the young.
9. More generous unemployment benefits increase reservation wage and, therefore, reduce unemployment.
10. Efficiency wage hypothesis is the only reason why high-tech firms pay more than McDonald's.

II. Unemployment Statistics

Suppose that during a given month, the U.S. noninstitutional civilian population is 260 million, of which 120 million are employed and 10 million are unemployed.

Calculate:

- (a) The labor force participation rate.
- (b) The unemployment rate.
- (c) The nonemployment rate.

### III. The Natural Rate of Unemployment

Suppose that the firm's markup over costs is 10%, and that the wage determination equation  $W = P(1-u)$ , where  $u$  is the unemployment rate.

- (a) What is the real wage as determined by the price-setting equation?
- (b) What is the natural rate of unemployment?
- (c) Suppose that the mark-up over costs increases to 20%. What will happen to the natural rate of unemployment? Explain the logic behind your result.

### IV. IS-LM and AS-AD

For each of the following changes, state which curve or curves are affected initially (IS, LM, AS, and AD) and in which direction they will initially shift.

- (a) An increase in government spending
  - (b) An increase in the nominal money supply
  - (c) An increase in the price of oil
  - (d) A decrease in consumer confidence
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