Econ 20B- Additional Problem Set

I. MULTIPLE CHOICES. Choose the one alternative that best completes the statement to answer the question.

1. If the minimum wage increased, then at any given rate of inflation
   a. both output and employment would be higher.
   b. neither output nor employment would be higher.
   c. output would be higher and unemployment would be lower.
   d. output would be lower and unemployment would be higher.

ANS: D PTS: 1 DIF: 2 REF: 35-2
TOP: Long-run Phillips curve | Minimum wage MSC: Analytical

2.If inflation expectations rise, the short-run Phillips curve shifts
   a. right, so that at any inflation rate unemployment is higher in the short run than before.
   b. left, so that at any inflation rate unemployment is higher in the short run than before.
   c. right, so that at any inflation rate unemployment is lower in the short run than before.
   d. left, so that at any inflation rate unemployment is lower in the short run than before.

ANS: A PTS: 1 DIF: 2 REF: 35-2
TOP: Inflation expectations MSC: Analytical

3. A policy intended to take reduce unemployment by taking advantage of a tradeoff between inflation and unemployment leads to
   a. both higher inflation and higher unemployment in the long run.
   b. higher inflation and no reduction in unemployment in the long run.
   c. the same inflation rate and lower unemployment in the long run.
   d. higher inflation and lower unemployment in the long run

ANS: B PTS: 1 DIF: 1 REF: 35-2
TOP: Expansionary policy MSC: Interpretive

4. In the long run an increase in the money supply growth rate effects
   a. the inflation rate and the natural rate of unemployment.
   b. the inflation rate, but not the natural rate of unemployment.
   c. neither the inflation rate nor the natural rate of unemployment.
   d. the natural rate of unemployment, but not the inflation rate.

ANS: B PTS: 1 DIF: 2 REF: 35-2
TOP: Long-run Phillips curve | Expansionary policy MSC: Analytical

5.If in response to an adverse aggregate supply shock the Fed increased the money supply,
   a. unemployment and inflation would both rise.
   b. unemployment and inflation would both fall.
   c. unemployment would rise and inflation would fall.
   d. unemployment would fall and inflation would rise.

ANS: D PTS: 1 DIF: 3 REF: 35-3
TOP: Accommadation MSC: Analytical

6.Which of the following is correct if there is a favorable supply shock?
   a. the short-run aggregate supply curve and the short-run Phillips curve both shift right.
   b. the short-run aggregate supply curve and the short-run Phillips curve both shift left.
   c. the short-run aggregate supply curve shifts right and the short-run Phillips curve shifts left.
   d. the short-run aggregate supply curve shifts left and the short-run Phillips curve shifts right.

ANS: C PTS: 1 DIF: 2 REF: 35-3

TOP: Phillips curve | Aggregate supply | Supply shocks MSC: Applicative

7.If the Fed reduces inflation 1 percentage point and this makes output fall 5 percentage points and unemployment rises 2 percentage points for one year, the sacrifice ratio is

a. 1/5.
b. 2.
c. 5/2.
d. 5.

ANS: D PTS: 1 DIF: 2 REF: 35-4
TOP: Sacrifice ratio MSC: Applicative

8.Which of the following is disinflation?

a. prices stay the same.
b. prices fall.
c. prices rise at a slower rate than they used to.
d. prices rise as a faster rate than they used to.

ANS: C PTS: 1 DIF: 2 REF: 35-4
TOP: DisinflationMSC: Definitional

9.The theory by which people optimally use all available information when forecasting the future is known as

a. rational expectations.
b. perfect expectations.
c. credible expectations.
d. predictive expectations.

ANS: A PTS: 1 DIF: 1 REF: 35-4
TOP: Rational expectations MSC: Definitional

10.Most economists believe that a tradeoff between inflation and unemployment exists

a. only in the short run.
b. only in the long run.
c. in both the short and long run.
d. in neither the short nor long run.

ANS: A PTS: 1 DIF: 1 REF: 35-4
TOP: Phillips curve MSC: Definitional

11.In the long run, the inflation rate depends primarily on

a. the ability of unions to raise wages.
b. government spending.
c. the money supply growth rate.
d. the monopoly power of firms.

ANS: C PTS: 1 DIF: 2 REF: 35-1
TOP: Inflation MSC: Definitional

12.Unemployment would decrease and prices increase if

a. aggregate demand shifted right.
b. aggregate demand shifted left.
c. aggregate supply shifted right.
d. aggregate supply shifted left.

ANS: A PTS: 1 DIF: 2 REF: 35-1
TOP: Short-run equilibrium MSC: Applicative

13.If the short-run Phillips curve were stable, which of the following would be unusual?

a. an increase in government spending and a fall in unemployment
b. an increase in inflation and a decrease in output
c. a decrease in the inflation rate and a rise in the unemployment rate
d. a decrease in the money supply and a rise in unemployment.

ANS: B PTS: 1 DIF: 2 REF: 35-1
TOP: Short-run Phillips curve MSC: Interpretive

14.According to classical macroeconomic theory, in the long run

a. monetary growth affects both real and nominal variables.
b. the only real variable affected by monetary growth is the unemployment rate.
c. a number of factors that affect unemployment are influenced by monetary growth.
d. monetary growth affects nominal but not real variables.

ANS: D PTS: 1 DIF: 1 REF: 35-2
TOP: Classical theory MSC: Interpretive

15. The existence of sticky wages leads to a positive relationship between the actual price level and the quantity of output supplied

a. in both the short and long run.
b. in the short run, but not the long run.
c. in the long run, but not the short run.
d. in neither the short nor the long run.

ANS: B PTS: 1 DIF: 1 REF: 35-2

16. Which of the following would shift the long-run Phillips curve right?

a. expansionary fiscal policy.
b. an increase in the inflation rate.
c. increases in unemployment compensation.
d. None of the above is correct.

ANS: C PTS: 1 DIF: 2 REF: 35-2
TOP: Long-run Phillips curve MSC: Applicative

17. A decrease in expected inflation shifts

a. the long-run Phillips curve left.
b. the short-run Phillips curve left.
c. neither the short-run nor long-run Phillips curve left.
d. both the short-run and long-run Phillips curve left.

ANS: B PTS: 1 DIF: 1 REF: 35-2
TOP: Inflation expectations | Phillips curve MSC: Applicative

III. SHORT ESSAYS. Answer the following questions briefly but concisely.

1. Are the effects of an increase in aggregate demand in the aggregate demand and aggregate supply model consistent with the Phillips curve? Explain.

ANS:

Consider what happens when the aggregate-demand curve shifts. For example, suppose there is an increase in aggregate demand. The aggregate demand and supply model shows that prices and output will rise. Rising prices mean that there is inflation. Rising output means falling unemployment. Thus, a shift in the aggregate-demand curve along the aggregate-supply curve corresponds to a movement along the Phillips curve.

PTS: 1 DIF: 2 REF: 35-1
TOP: Aggregate demand and supply | Phillips curve MSC: Analytical

4. Suppose that the Fed unexpectedly pursues contractionary monetary policy. What will happen to unemployment in the short run? What will happen to unemployment in the long run?

ANS:

In the short run, unemployment will rise, because, contractionary policy reduces actual inflation and so moves the economy down along the Phillips curve. In the long run, the economy will return to its natural rate of unemployment as the short-run Philip curve shifts left as inflation expectations fall.

PTS: 1 DIF: 2 REF: 35-2

TOP: Phillips curve | Contractionary policy MSC: Analytical

9.Some economists argue that simply and suddenly reducing money supply growth is a costly way to reduce inflation and that it may not work. For example, if a government cuts money growth but makes no real fiscal reforms, people will expect the government will eventually need to expand the money supply to pay for its expenditures. Thus, the promise to fight inflation will not be credible. Explain why credibility is important to a reduction in the inflation rate.

ANS:

If people believe that the government really will honor its promise to reduce inflation, than inflation expectations fall. This change in expectations shifts the short-run Phillips curve left so that at any actual inflation rate the unemployment rate will be lower. If the government reduces money supply growth and at the same time people reduce their inflation expectations, unemployment will rise by less than if people maintain their inflation expectations. The same argument can be made using the following equation.

Unemployment rate = natural rate of unemployment - a(actual inflation - expected inflation)

Suppose the government reduces actual inflation. If expected inflation is unchanged, then the unemployment rate rises by more than if people revise their expectations of inflation downward.

PTS: 1 DIF: 3 REF: 35-4

TOP: Credibility MSC: Analytical