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**ECON 212 – Principles of Economics II**

**Problem Set 6**

**LONG QUESTIONS:**

1) According to the Ricardian equivalence theorem, why is government spending offset by a reduction in private spending?

According to the Ricardian equivalence theorem, government spending offset by a reduction in private spending because people increase their savings in anticipation of an increase in taxes in the future to pay for that deficit.

2) If interest rates have no effect on investment, how much crowding out will occur?

There will be no crowding out.

3) According to crowding out, how is government spending offset by a reduction in private spending?

Government spending increases the demand for loanable funds and increases the interest rate. An increase in the interest rate reduces private investment spending, which offsets the effect of increases in government spending on aggregate demand.

4) Categorize each of the following as cyclical or structural unemployment:

a. An autoworker is laid off during a recession until car sales pick up. Cyclical Unemployment

b. A steelworker loses his job because steel is now produced in foreign countries with lower wages. Structural Unemployment

c. A compositor loses her job because the work is now outsourced to China. Structural Unemployment

d. An unemployed person turns down job offers that do not pay the wages of his previous job. Structural Unemployment

e. A steel worker loses his job because the economy slows down. Cyclical Unemployment

**MULTIPLE CHOICE QUESTIONS:**

**1)** Fill in the blanks.

Crowding out is the offsetting of a change in \_\_\_\_\_\_\_\_\_ by a change in \_\_\_\_\_\_\_\_\_ in the opposite direction.

A) consumption, investment

B) government expenditures, net exports

C) government expenditures, private expenditures

D) government expenditures, investment

**2)** What is an automatic stabilizer?

A) An automatic stabilizer is any government program or policy that will counteract the business cycle without any new government action

B) A view of fiscal policy that the government budget should always be balanced except in wartime

C) Reserves kept in good times to offset declines in revenues during recessions

D) Changes in government spending and taxes that increase the cyclical fluctuations in the economy instead of reducing them

**3)** What is the fiscal policy dilemma?

A) It is long-term unemployment that occurs because of changes in the structure of the economy and cannot be resolved by macro policies.

B) It is what to do in periods of structural stagnation when both deficits and a balanced budget are called for.

C) It is a view of fiscal policy that the government budget should always be balanced except in wartime.

D) It is the offsetting of a change in government expenditures by a change in private expenditures in the opposite direction.

**4)** What is the definition of sound finance?

A) A view of fiscal policy that the government budget should always be balanced except in wartime.

B) Governments should make spending and taxing decisions on the basis of their effect on the economy, not on the basis of some moralistic principle that budgets should be balanced.

C) It is the offsetting of a change in government expenditures by a change in private expenditures in the opposite direction.

D) It is any government program or policy that will counteract the business cycle without any new government action.

**5)** What is Okun's rule of thumb?

A) a 2 percentage point rise in the unemployment rate will tend to be associated with a 1 percent fall in output from its trend and vice versa.

B) a 2 percentage point rise in the unemployment rate will tend to be associated with a 1 percent rise in output from its trend and vice versa.

C) a 1 percentage point rise in the unemployment rate will tend to be associated with a 2 percent fall in output from its trend and vice versa.

D) a 1 percentage point rise in the unemployment rate will tend to be associated with a 2 percent rise in output from its trend and vice versa.

**6)** If unemployment rises by 2%, what will likely to happen to output in this country relative to its growth trend?

A) Output will decrease by 1%

B) Output will increase by 1%

C) Output will decrease by 4%

D) Output will increase by 4%

**7)** Using Okun's rule of thumb, if trend growth is 3% and the unemployment rate rises by 2%, what will happen to output?

A) Output will decrease by 1%

B) Output will increase by 1%

C) Output will decrease by 7%

D) Output will increase by 7%

**7)** Using Okun's rule of thumb, if trend growth is 3% and the unemployment rate falls by 1%, what will happen to output?

A) Output will decrease by 1%

B) Output will increase by 1%

C) Output will decrease by 5%

D) Output will increase by 5%

**9)** What is cyclical unemployment?

A) When individuals lose jobs due to a fall in aggregate demand, often during an economic recession.

B) Individuals are unemployed due to a lack in skills that modern industries need, change in technology.

C) When an individual is unemployed because they are looking for a new job.

D) When individuals are unemployed due to a change in season.

**10)** What is structural unemployment?

A) When individuals lose jobs due to a fall in aggregate demand, often during an economic recession.

B) Individuals are unemployed due to a lack in skills that modern industries need, change in technology.

C) When an individual is unemployed because they are looking for a new job.

D) When individuals are unemployed due to a change in season.

11) Structural unemployment is the

A) portion of unemployment that is due to changes in the structure of the economy that result in a significant loss of jobs in certain industries.

B) unemployment that occurs during recessions and depressions.

C) portion of unemployment that is due to the normal working of the labor market.

D) unemployment that results when people become discouraged about their chances of finding a job so they stop looking for work

12) The increase in unemployment that occurs during recessions and depressions is called **(C)**

A) frictional unemployment.

B) structural unemployment.

C) cyclical unemployment.

D) normal unemployment.

13) Unemployment that occurs during the normal workings of an economy as people change jobs and move across the country is called

A) structural unemployment.

B) frictional unemployment.

C) natural unemployment.

D) cyclical unemployment

14) In the work-leisure choice model, if the wage rate increases from below Linda's reservation wage to

above Linda's reservation wage, then

A. Linda will work less.

B. Linda will enter the labour force.

C. Linda will choose more leisure.

D. Linda will start having reservations about her current job.

15) An individual who starts, creates and manages a new business can be called **(D)**

A. A leader

B. A manager

C. A Professional

D. An entrepreneur