EC1B5 | Chapter 12

Economic Fluctuations

Additional Practice Questions:

Book Question 4

Suppose that the mythical country Moricana has a downward rigid wage. Moricana is in a recession; capacity utilization in the economy is at an all-time low, and surveys show that firms do not expect economic conditions to improve in the coming year.

a. Firms in the country are cutting back on capital spending and investment. Use a graph to show how this would affect the labor demand curve (ignore the effects of multipliers).

b. Is unemployment in Moricana likely to be classified as voluntary or involuntary? Explain your answer.

Book Question 5

Answer the following and illustrate your answers on a graph.

a. Assuming flexible wages, how will wages react to a fall in labor demand?

b. What options do workers have in this case?

Book Question 7

In 1973, the major oil-producing nations of the world declared an oil embargo. The price of oil, a key source of energy, increased. In many countries, this led to a fall in real GDP and employment. Which of the three business cycle theories explained in the chapter – real business cycle theory, Keynesian theory, and monetary theory – would best fit this explanation of the 1973 recession?

Book Question 11

The global outbreak of COVID-19 in 2020 wreaked havoc on most economies. The containment efforts of the pandemic were proving to be detrimental to economic activity leading many countries to relax the lockdown even when the objective of the containment was not reached. How do you think the labor demand curve was affected because of the pandemic? How do you imagine countries are reacting to cushion the effect of the fall in economic activity on businesses and household incomes? Use a graph to illustrate your answer.