Quiz 5 – Answers

Question 1
Which of the following might decrease unemployment?

A. Forcing all firms in an industry to pay the same wage
B. Unemployment benefits that are halved every time a job offer is rejected
C. Eliminating the minimum wage
D. Decreasing the wage setting power of labour unions
E. A and B only
F. A and D only
G. A, B and C only
H. A, B, C and D

Explanation: A would concentrate wage distribution, thus eliminating any value from rejecting a job offer; B lowers the value of rejecting the job offer; C and D could decrease unemployment by allowing the wage to come back to the competitive wage.

Question 2
In response to high unemployment, the Spanish government enacted a series of labor market reforms in 2012. Among other measures, the government reduced severance pay and the influence of unions in setting wages and hours of work.
What could be the rationale behind using these measures to boost employment?

A. The logic behind these measures was to lower wage inequality since collective bargaining and severance pay tend to benefit the wealthy at the expense of the poor.
B. The rationale behind these measures was to lower unemployment by addressing the wage rigidity caused by unions and firms' unwillingness to hire new employees because of severance pay obligations.
C. The Spanish government wanted to raise government revenue since union pay and severance pay were not subject to taxation by the government.

Question 3

According to salary.com, the average salary for a software engineer level III (a higher-level position in software design and implementation) in the Silicon Valley area of California is $108,244.

However, Google pays its level III software engineers an average salary of $124,258.
Why does Google pay a salary higher than the equilibrium salary for equivalent positions in the same area?

A. Google does not know what other firms in the same area are paying and unknowingly set its wages far above the equilibrium salary.
B. Google is paying an efficiency wage in order to minimize worker turnover, increase worker productivity, and attract the top talent.
C. Google is the only firm in the Silicon Valley area whose workers are not in a union; thus, it is able to pay its workers more than other firms that have unionized workers.
D. Since Google is such a large firm and produces a product used by so many people, the government mandates an efficiency wage that Google must pay its engineers.

The question is designed to discuss efficiency wage theory

<u>Question 4</u>
Which of the following are true about nominal and real interest rates?

A. The nominal interest rate always exceeds the real interest rate.
B. The nominal interest rate is the rate you pay on a loan.
C. The real interest rate is the nominal interest rate adjusted for inflation.
D. A and B only
E. A and C only
F. B and C only
G. All are correct

Handout 9, slides 6-10

<u>Question 5</u>

The credit demand curve slopes downward because

A. a lender's ability to make loans falls as the real interest rate rises.
B. households seek to borrow more when their outlook for the future improves.
C. government borrowing increases when budget deficits increase, and vice versa.
D. The marginal product of capital is declining

Handout 9, slide 12

<u>Question 6</u>
A shift in the credit demand curve can be caused by

A. changes in perceived business opportunities for firms.
B. changes in households' preferences for durables.
C. changes in government policy.
D. the introduction of a new saving product
E. A, B and C only
F. A, C and D only
G. A and D only
H. B and C only
I. All of them

Handout 9, slide 14. D should affect credit supply curve instead of credit demand curve

<u>Question 7</u>
The credit supply curve slopes upward because a

A. higher real interest rate induces more investment.
B. higher real interest rate discourages current consumption.
C. higher real interest rate encourages more saving.
D. A and B only
E. A, B and C
F. A and C only
G. B and C only

B and C are two ways of looking at the same concept. See handout 9, slide 19-25.

<u>Question 8</u>

The 1970s saw a period of high inflation in many industrialized countries including the United States. Due to the increase in the rate of inflation, lenders, including credit card companies, revised their nominal interest rates upward.
How is the rate of inflation related to the nominal interest rate that credit card companies charge, and why would lenders need to increase the nominal interest rate when the inflation rate increases?

A. The nominal rate of interest and the inflation rate are inversely related; lenders need to raise the nominal rate when inflation increases to satisfy government regulations on lending practices.

B. The nominal rate of interest is the real rate of interest less the rate of inflation; lenders need to raise the nominal rate when inflation increases to maintain their desired real return.
C. The nominal rate of interest is the real rate of interest plus the rate of inflation; lenders need to raise the nominal rate when inflation increases to maintain their desired real return.
D. The nominal rate of interest is the real rate of interest plus the rate of inflation; lenders need to raise the nominal rate when inflation increases to stabilize credit market activity.

The question aims at discussing Fisher's equation

Question 9

A person receives a job offer at a wage equal to $9. Which of the following might convince the worker to reject the offer?

A. Unemployment insurance
B. Nearly all firms in the industry offering a $7 wage
C. Minimum wage at $8
D. Partner's high earnings
E. A and B only
F. A and C only
G. A and D only
H. A, C and D

Explanation: A, C and D raise the reservation wage, so that makes the worker more likely to reject the offer; B works in opposite direction as it makes it unlikely for the person to receive any better job offers.