

Exam

Name \_\_\_\_\_

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

1) The labour force is the sum of

- A) employed workers and unemployed workers.
- B) employed workers and individuals not looking for work.
- C) employed workers and the working-age population.
- D) unemployed workers and the working-age population.

Answer: A

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

2) The unemployment rate is the

- A) percentage of the labour force receiving unemployment benefits.
- B) percentage of the population that is unemployed.
- C) percentage of the working-age population that is unemployed.
- D) percentage of the labour force that is unemployed.

Answer: D

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

3) When the Australian Bureau of Statistics conducts surveys to estimate the rate of unemployment, one of the survey questions asked is?

- A) Does the person have any skills?
- B) Has the person looked for work during the past year?
- C) Is the person currently available to start work?
- D) Has the person worked for 10 hours or more in the past week?

Answer: C

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

4) A full-time student who is not working is categorised as

- A) unemployed.
- B) employed.
- C) not in the labour force.
- D) a discouraged worker.

Answer: C

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

5) Jack lost his job six months ago, and he's been actively looking for a new job ever since. The Australian Bureau of Statistics would classify Jack as

- A) unemployed.
- B) out of the labour force.
- C) a discouraged worker.
- D) None of these options is correct.

Answer: A

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

6) Discouraged workers are classified by the Australia Bureau of Statistics as

- A) part of the labour force.
- B) not in the labour force.
- C) unemployed.
- D) employed.

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

7) Discouraged workers are

- A) not considered part of the unemployed because they are not actively seeking work.
- B) considered part of the unemployed because they are not working.
- C) considered part of the unemployed because they are still in the labour force.
- D) not considered part of the unemployed because they are not qualified to work.

Answer: A

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

8) The \_\_\_\_\_ is the total number of people aged 15 years and over, and the \_\_\_\_\_ is the number of people either employed or unemployed.

- A) labour force participation rate; labour force
- B) working-age population; labour force
- C) labour force; working-age population
- D) working-age population; labour force participation rate

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

9) If a part-time worker becomes a full-time worker, the

- A) official unemployment rate will fall.
- B) official unemployment rate will not change.
- C) economy will move closer toward full employment.
- D) economy will move closer toward the natural rate of unemployment.

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

10) Which of the following will *not* lower the official measure of the unemployment rate?

- A) Older workers taking early retirement.
- B) People losing their full-time jobs and being given part-time jobs instead.
- C) An increase in the number of discouraged workers.
- D) An economic boom.

Answer: B

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

11) The unemployment rate is calculated by

- A) dividing the number of unemployed people by the sum of the number of working people plus the number of unemployed people, and multiplying by 100.
- B) dividing the number of unemployed people by the number of working individuals, and multiplying by 100.
- C) dividing the number of unemployed people by the number in the working-age population, and multiplying by 100.
- D) dividing the number of unemployed people by the number of people in the labour force, and dividing by 100.

Answer: A

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

12) The labour force is the

- A) number of people employed minus the number of people unemployed.
- B) number of people employed plus the number of people unemployed.
- C) ratio of the number of people employed to the number of people unemployed.
- D) ratio of the number of people employed to the working-age population.

Answer: B

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

13) A retired person is classified as

- A) unemployed.
- B) not in the labour force.
- C) under-employed.
- D) part-time employed.

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

14) The unemployment rate is measured as the

- A) number of unemployed people divided by the number of employed people, multiplied by 100.
- B) number of unemployed people divided by the labour force, multiplied by 100.
- C) number of unemployed people divided by the total population, multiplied by 100.
- D) labour force minus the number of unemployed, multiplied by 100.

Answer: B

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

15) The labour force participation rate is defined as the percentage of the

- A) working-age population that is employed.
- B) working-age population that is unemployed.
- C) labour force that is employed.
- D) working-age population in the labour force.

Answer: D

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

16) If people who have been looking for work give up actively looking for work, ceteris paribus, the

- A) unemployment rate increases.
- B) labour force participation rate increases.
- C) unemployment rate decreases.

D) working-age population decreases.

Answer: C

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

17) Which of the following would reduce the labour force participation rate, all else being equal?

A) An increase in the number of people in the labour force.

B) An increase in the unemployment rate.

C) A decrease in the unemployment rate.

D) An increase in the working-age population.

Answer: D

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

18) Around 1500 people who were unemployed last month started new jobs this month. As a result of this increase in the number of employed workers, which of the following occurred (*ceteris paribus*)?

A) The labour force participation rate increased.

B) The unemployment rate increased.

C) The labour force participation rate decreased.

D) The unemployment rate decreased.

Answer: D

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

19) During an economic boom, many employees are asked to work more overtime hours each week. As a result of this

A) the unemployment rate increases.

B) the unemployment rate decreases.

C) the labour force participation rate increases.

D) neither the unemployment rate nor the labour force participation rate changes.

Answer: D

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

20) Refer to the following table.

	Persons
Employed	8000
Unemployed	500
Not in the labour force	4000

All of the following mathematical calculations are correct. The unemployment rate is approximately

A)  $(500/8000) \times 100 = 6.25$  per cent.

B)  $(500/7500) \times 100 = 6.67$  per cent.

C)  $(500/8500) \times 100 = 5.88$  per cent.

D)  $(500/4000) \times 100 = 12.5$  per cent.

Answer: C

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

21) Refer to the following table.

	Persons
Employed	11 000
Unemployed	600
Population	22 000

All of the following mathematical calculations are correct. The unemployment rate is approximately

- A)  $(600/11\ 000) \times 100 = 5.45$  per cent.
- B)  $(600/22\ 000) \times 100 = 2.73$  per cent.
- C)  $(600/10\ 400) \times 100 = 5.77$  per cent.
- D)  $(600/11\ 600) \times 100 = 5.17$  per cent.

Answer: D

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

22) If the number employed is 11 million, the working-age population is 16 million, and the number unemployed is 0.6 million, then the unemployment rate is

- A) 5.45 per cent.
- B) 5.17 per cent.
- C) 3.75 per cent.
- D) 12 per cent.

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

23) If the number employed is 11 million, the number unemployed is 0.6 million, and the working-age population is 16 million, then the labour force participation rate is:

- A) 65.0 per cent.
- B) 72.5 per cent.
- C) 68.75 per cent.
- D) 71.4 per cent.

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

24) In Australia in early 2014, approximately how many people were in the labour force?

- A) 6.3 million
- B) 12 million
- C) 18.3 million
- D) 11.4 million

Answer: B

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

25) In Australia in early 2014, approximately how many people were *not* in the labour force but were of working age?

- A) 6.6 million
- B) 12 million
- C) 0.6 million

D) 11.4 million

Answer: A

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

26) The official unemployment rate may understate the true rate of unemployment because of

- A) increases in worker productivity over time.
- B) discouraged workers who no longer actively look for work.
- C) workers who have more than one job.
- D) changes in the wage rates which may increase unemployment.

Answer: B

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

27) Which of the following causes the official measure of the unemployment rate to understate the true extent of joblessness?

- A) Many full-time workers really want to be part-time workers.
- B) People who collect unemployment benefits report themselves to be searching for a job.
- C) Discouraged workers are not counted as unemployed.
- D) Discouraged workers are counted as unemployed.

Answer: C

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

28) Which of the following is *not* an incentive for people to provide inaccurate employment information to the Australian Bureau of Statistics?

- A) People are embarrassed about being in low paid jobs.
- B) Some people are employed in illegal activities.
- C) People want to avoid paying taxes on earnings.
- D) People think they might lose unemployment benefits if they declare that they have been working.

Answer: A

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

29) Which of the following describes actual trends in the Australian labour force participation rate?

- A) The labour force participation rate of adult men has risen since the late 1970s.
- B) The labour force participation rate of adult women has fallen since the late 1970s.
- C) The labour force participation rate of adult men not in school, but too young to retire, has risen since the late 1970s.
- D) The labour force participation rate of adult women has risen since the late 1970s.

Answer: D

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

30) Which of the following is *true* about the Australian labour force participation rate?

- A) The labour force participation rate of adult men fell between 1978 and 2004.
- B) The labour force participation rate of adult women fell between 1978 and 2004.
- C) The labour force participation rate of adult men has increased from 1978 to 2010.
- D) The labour force participation rate of adult women rose in the 1980s and fell again during the 1990s.

Answer: A

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

31) Except for during recessions, the duration of unemployment for the typical person in Australia lasts

- A) less than six months.
- B) over two years.
- C) between six and nine months.
- D) over one year.

Answer: A

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

32) Long-term unemployment is defined as

- A) those in the labour force who have been unemployed continuously for 6 months or more.
- B) those in the labour force who have been unemployed continuously for 12 months or more.
- C) those in the labour force who have been unemployed continuously for 2 years or more.
- D) people who are no longer in the workforce as they are discouraged workers.

Answer: B

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

33) In Australia in 2014, the proportion of unemployed people who were long-term unemployed as measured by the Australian Bureau of Statistics was approximately

- A) 5.7 per cent.
- B) 7.6 per cent.
- C) 22 per cent.
- D) 24 per cent.

Answer: C

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

34) In Australia between 1978 and 2013, the net number of

- A) part-time jobs and full-time jobs fell.
- B) part-time jobs grew while full-time jobs fell.
- C) full-time jobs grew while part-time jobs fell.
- D) part-time jobs and full-time jobs grew.

Answer: D

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

35) In Australia between 2003 and 2013

- A) the fastest job growth was experienced in the full-time job category.
- B) the fastest job growth was experienced in the part-time job category.
- C) total *net* jobs growth fell.
- D) the unemployment rate rose.

Answer: B

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

36) The unemployment rate is calculated by adding up the number of people receiving unemployment benefit payments from the government.

Answer: True ☒ False

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

37) The unemployment rate is the number of unemployed divided by the working-age population.

Answer: True ☒ False

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

38) Over the past 30 years, the labour force participation rates of women have fallen as they leave the labour force to have children, while the labour force participation rates of men have risen.

Answer: True ☒ False

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

39) The labour force participation rates of men in Australia have gradually increased since 1978.

Answer: True ☒ False

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

40) The Australian economy destroys hundreds of thousands of jobs every year, even when the economy is experiencing strong growth.

Answer: ☒ True False

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

41) Explain why discouraged workers are *not* measured as being unemployed.

Answer: They are not measured as unemployed because to be measured as unemployed a person must be actively looking for work. Discouraged workers have given up looking for work.

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

42) For each of the following, indicate if the person would be classified as employed, unemployed, or not in the labour force: (i) a 65-year-old man who left his job and is now working as a volunteer for 10 hours a week; (ii) a university graduate who has not been able to find a position using her skills and is working as a wait-person for 30 hours a week; and (iii) a manufacturing worker who is out of a job and has given up searching for a job.

Answer: These individuals would be classified: (i) not in the labour force, (ii) employed, and (iii) not in the labour force.

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

43) Suppose 180 000 people are employed, 20 000 people are unemployed, the working-age population is 250 000 and 50 000 people are out of the labour force. Calculate the unemployment rate.



Answer: The unemployment rate is calculated as:  $(\text{Number unemployed} / \text{Labour force}) \times 100$

The labour force is the sum of those employed plus the unemployed. This is 180 000 plus 20 000 which equals 200 000 people. Substituting this information into the equation:

$$(20\,000 / 200\,000) \times 100 = 10 \text{ per cent.}$$

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

44) Suppose 180 000 people are employed, 20 000 people are unemployed, and an additional 50 000 people are not in the labour force but are of working age. Calculate the labour force participation rate.

Answer: The labour force participation rate is calculated as:

$$(\text{Labour force} / \text{Working-age population}) \times 100$$

The labour force is the sum of those employed plus the unemployed. This is 180 000 plus 20 000 which equals 200 000 people. The working-age population is the sum of those in the labour force and those not in the labour force but of working age. This is 200 000 plus 50 000 which equals 250 000. Substituting this information into the equation:

$$(200\,000 / 250\,000) \times 100 = 80 \text{ per cent.}$$

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Application of knowledge

45) How would the unemployment rate and the labour force participation rate change if discouraged workers were counted as unemployed rather than as being in the 'not-in-the-labour force' category? Show this using the formula for both measurements.

Answer: The unemployment rate is calculated as:

$$(\text{Number unemployed} / \text{Labour force}) \times 100$$

Including discouraged workers would increase the number of people counted as being in the labour force and would increase the number of people counted as unemployed. In terms of the calculation, the numerator would rise, and the denominator would rise. However, the numerator would rise by a greater percentage than the denominator, as the denominator is the sum of employment plus unemployment. If the top number rises more quickly than the bottom number, then the whole number rises. This would increase the unemployment rate.

The labour force participation rate is calculated as:

$$(\text{Labour force} / \text{Working-age population}) \times 100$$

Including discouraged workers would increase the number of people in the labour force, but not change the number of people in the working-age population. Increasing the numerator of a fraction increases the fraction. This would, therefore, increase the labour force participation rate because the numerator has increased.

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

46) The Australian Bureau of Statistics counts as employed people who work part-time, but would prefer to work full-time. Suppose the people who had part-time jobs, but wanted full-time jobs, were counted as unemployed. Explain how the unemployment rate and the labour force participation rate would change.

Answer: The unemployment rate would increase and the labour force participation rate would stay the same. The

number of unemployed would rise, but the labour force would stay the same. The part-time workers who wanted to be full-time workers would simply go from being employed to unemployed. With no change in the labour force, the labour force participation rate would not change.

Diff: 3

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

47) How has the labour force participation rate changed for men and women over the past 30 years in Australia?

Answer: Generally, the labour force participation rate has been rising for women and falling for men. Note that the male participation rate rose slightly around the mid-2000s.

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

48) Why are jobs continually being created and destroyed in the economy?

Answer: New jobs are created as technology progresses, consumer tastes change and entrepreneurs successfully create new businesses. Jobs are destroyed due to changes in consumer tastes, new technologies making some jobs redundant, and some entrepreneurs failing in their business ventures.

Diff: 2

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

49) Explain how the rate of unemployment is measured and discuss the weaknesses of this method of measurement.

Answer: The unemployment rate is measured based on the labour force survey conducted monthly by the Australian Bureau of Statistics (ABS). People are considered to be unemployed if they have not worked for one hour or more in the past week, are currently available to start work, and have been looking for work for the past four weeks. The unemployment rate is then calculated as the number of people unemployed divided by the number of people in the labour force, multiplied by 100. Weaknesses with this method include: it does not take account of under-employment, that is, people who are working less hours than they would like to; it does not include discouraged workers; there may be reasons why people have not been looking for work or are not available to start immediately, but they would still like a job; and some people do not declare that they are working to avoid paying taxation because they are involved in illegal work, or because they are receiving unemployment benefits when they are working and think that telling this to the ABS will cause them to lose their benefits.

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

50) Discuss the trends in labour force participation in Australia over the past 30 years.

Answer: Overall, the labour force participation rate in Australia has risen significantly over the past 30 years. In particular, female participation rates rose sharply during the 1980s, due to changing social attitudes, federal anti-discrimination legislation, increased wages for women, women having fewer children, and the growth of the services sector (the sector in which females are most highly represented). Between 1978 and 2010, the female participation rate rose from 44 per cent to 58.6 per cent. The participation rate for males has fallen slowly since the late 1970s, from 79 per cent in 1978 to a low of 71.5 per cent in 2004. The general decline over time in male labour force participation rates has been due to younger retirement ages and males staying at school longer. The rate rose slightly between 2004 and 2010 to 72.3 per cent.

Diff: 1

A-Head 13.1: Measuring the Unemployment Rate and the Labour Force Participation Rate

AACSB: Analytic thinking

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

51) Which of the following is *not* a result of rising unemployment?

A) A loss of tax revenue to the government.

B) An increase in poverty.

C) An increase in wages for those who remain in employment as there are fewer people employed.

D) Lower incomes for people who become unemployed.

Answer: C

Diff: 1

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

52) Which of the following is an economic cost of rising unemployment rates?

A) Loss of GDP.

B) An inward shift in the production possibility frontier.

C) A fall in the amount of unemployment benefits paid by the government.

D) An increase in income levels, as people who lose their jobs move onto the unemployment benefits.

Answer: A

Diff: 2

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

53) Unemployment in Australia is

A) significantly higher among older people than younger people.

B) one of the main causes of poverty.

C) does not lead to an increase in poverty as unemployed people receive unemployment benefits from the government.

D) equally distributed across all age groups in society.

Answer: B

Diff: 2

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

54) In 2014, the unemployment rate in Australia was highest for people in the age group

A) 15-19 years.

B) 20-24 years.

C) 55-59 years.

D) 60-64 years.

Answer: A

Diff: 1

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

55) For which of the following age groups was the unemployment rate in Australia the lowest in 2014?

A) 15-19 years

B) 25-34 years

C) 35-44 years

D) 60-64 years

Answer: D

Diff: 1

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

56) During periods of rising unemployment, the government receives less tax revenue from individuals and from businesses.

Answer: ☒ True ☐ False

Diff: 2

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

57) The rate of unemployment in Australia is higher among 15-19-year-olds than 60-64-year-olds.

Answer: ☒ True      False

Diff: 1

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

58) Outline the costs of unemployment.

Answer: The economic costs of unemployment include loss of GDP, reduced income tax revenue to the government, reductions in firms' profits, the budgetary and opportunity costs of unemployment benefit payments, deterioration of skills of the unemployed, and loss of income to individuals when they become unemployed. Unemployment also has social costs which may include crime, family problems and health problems.

Diff: 2

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

59) Which groups of people in Australia are more likely to experience higher levels of unemployment?

Answer: The groups of people in Australia who are more likely to experience higher levels of unemployment are young people, particularly those aged between 15 and 19 years of age, and people with relatively lower levels of formal education.

Diff: 1

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

60) Why are policy makers concerned about rising unemployment rates?

Answer: There are significant economic costs due to unemployment. These include forgone GDP, that is, the economy will not be operating on its production possibility frontier; reduced income tax revenue to the government from both personal and company income taxes; reduced GST revenue to the government, as higher unemployment leads to less consumer spending; reductions in firms' profits as higher rates of unemployment lead to lower incomes, which leads to less spending on goods and services; the budgetary and opportunity costs of unemployment benefit payments, as the higher the rate of unemployment, the greater the amount the government must pay in unemployment benefits (funds which could otherwise be used for other purposes); and loss of human capital, as the longer people are unemployed, the more likely their skills will deteriorate or become out of date. Unemployment also imposes serious costs on the unemployed, including loss of income to individuals when they become unemployed (unemployment is one of the main causes of poverty); loss of skills; and loss of confidence. Unemployment also has social costs which may include crime, family problems and health problems.

Diff: 2

A-Head 13.2: The Costs of Unemployment

AACSB: Analytic thinking

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

61) The short-term unemployment arising from the process of matching workers with jobs is called

- A) frictional unemployment.
- B) structural unemployment.
- C) cyclical unemployment.
- D) seasonal unemployment.

Answer: A

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

62) Unemployment arising from a persistent mismatch between the skills and characteristics of workers and the requirements of jobs is called

- A) frictional unemployment.
- B) structural unemployment.
- C) cyclical unemployment.
- D) seasonal unemployment.

Answer: B

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

63) The unemployment resulting from workers laid off due to an economic contraction or a recession would be classified as

- A) frictional unemployment.
- B) structural unemployment.
- C) cyclical unemployment.
- D) natural unemployment.

Answer: C

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

64) People who lost their jobs as hand-drawn animators because of the popularity of computer generated 3D animation are examples of people who are experiencing

- A) frictional unemployment.
- B) structural unemployment.
- C) cyclical unemployment.
- D) seasonal unemployment.

Answer: B

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

65) Which of the following is an example of a worker experiencing cyclical unemployment?

- A) A worker who changes jobs to move closer her family.
- B) An assembly line worker who loses his job because of automation.
- C) A freightliner employee who was sacked because of a recession.
- D) A worker who quits his job because he does not get along with his boss.

Answer: C

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

66) Which of the following is an example of a worker experiencing frictional unemployment?

- A) A worker who quits his job at the post office to find more interesting work.
- B) A computer programmer who loses her job because it is outsourced to India.
- C) An employee who loses his job because the economy is suffering a recession.
- D) An airline pilot who loses her job because of lack of demand for air travel.

Answer: A

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

67) Jack just told his boss that he thinks his boss is an idiot. It is likely that Jack will be experiencing \_\_\_\_\_ unemployment in the near future.

- A) permanent

- B) cyclical
- C) frictional
- D) structural

Answer: C

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

68) Sarah is a full-time student who is not looking for work. What kind of unemployment is Sarah experiencing?

- A) Cyclical
- B) Structural
- C) Frictional
- D) Sarah is not experiencing unemployment of any kind because she is not currently part of the labour force.

Answer: D

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

69) Frictional unemployment would increase when

- A) there is a fall in aggregate demand.
- B) workers are replaced by machines and the workers do not have the skills necessary to perform new jobs.
- C) discouraged workers leave the labour force.
- D) the number of individuals who quit their job to find another increases.

Answer: D

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

70) An example of a seasonally unemployed worker would be a

- A) software engineer who loses his job because of declining demand for the software he writes.
- B) child care provider who quits her job to go back to university.
- C) General Motors Holden employee who loses her job because the company is downsizing its workforce.
- D) worker employed at a beachside resort who loses his job in winter.

Answer: D

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

71) A woman who quit her job to search for a job that better utilises her skills represents an example of

- A) structural unemployment.
- B) frictional unemployment.
- C) cyclical unemployment.
- D) seasonal unemployment.

Answer: B

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

72) The demand for new motor vehicles falls when the economy enters a downturn and, as a result, motor vehicle manufacturers sack some workers. This would be an example of

- A) structural unemployment.
- B) frictional unemployment.
- C) natural unemployment.
- D) cyclical unemployment.

Answer: D

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

73) The demand for new motor vehicles falls due to high oil prices and a move by people toward a greater use of public transport. As a result, motor vehicle manufacturers sack some workers. This would be an example of

- A) structural unemployment.
- B) cyclical unemployment.
- C) natural unemployment.
- D) frictional unemployment.

Answer: A

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

74) Cyclical unemployment is defined as unemployment that

- A) is due to changes in the structure of an economy.
- B) is due to an economic contraction or recession.
- C) occurs when people are searching for their first job.
- D) occurs when people become discouraged and stop looking for work.

Answer: B

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

75) Structural unemployment would increase when

- A) workers are replaced by machines and the workers do not have the skills to perform new jobs.
- B) the number of individuals who quit their job to find another increases.
- C) discouraged workers drop out of the work force.
- D) the economy enters a recession.

Answer: A

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

76) Frictional unemployment can be defined as unemployment that

- A) arises due to changes in technology in the economy.
- B) occurs as the result of a recession.
- C) occurs when people are re-entering the labour force.
- D) occurs when people have not had a job for 12 months or more.

Answer: C

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

77) A woman named Sheila, who retired, becomes bored and begins to look for a job. During the time she is searching for work, she would be classified as

- A) structurally unemployed.
- B) cyclically unemployed.
- C) frictionally unemployed.
- D) not unemployed because she was not working before she started looking for a job.

Answer: C

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Application of knowledge

78) Many economists argue that frictional unemployment

- A) no longer exists due to shortages of labour.
- B) cannot and probably should not be eliminated.
- C) should be eliminated.
- D) prevents the economy from reaching its full-employment output level.

Answer: B

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

79) The natural rate of unemployment is made up of

- A) frictional, cyclical and structural unemployment.
- B) frictional and cyclical unemployment.
- C) cyclical and structural unemployment.
- D) frictional and structural unemployment.

Answer: D

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

80) The labour market is considered to be at full employment when

- A) there are no unemployed workers.
- B) all unemployment is voluntary.
- C) all unemployment is frictional or structural.
- D) there are more unemployed workers than job vacancies.

Answer: C

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

81) The economy is at full employment if the unemployment rate is equal to

- A) zero.
- B) the natural rate of unemployment.
- C) the amount of cyclical unemployment.
- D) the sum of structural and cyclical unemployment.

Answer: B

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

82) When the labour market is at full employment

- A) there is only cyclical unemployment in the economy.
- B) there is only structural unemployment in the economy.
- C) the unemployment rate is 0 per cent.
- D) there is no cyclical unemployment in the economy.

Answer: D

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

83) When an economy is at its natural rate of unemployment which of the following will be *true*?



- A) The unemployment rate will be 0 per cent.
- B) The labour force participation rate will be 100 per cent.
- C) The unemployment rate will be greater than 0 per cent.
- D) Only structural unemployment as a result of technological change will exist in the economy.

Answer: C

Diff: 3

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

84) The natural rate of unemployment

- A) always fluctuates with the rate of inflation.
- B) is equal to cyclical unemployment.
- C) is a constant figure of about 4 per cent.
- D) occurs at a full-employment equilibrium.

Answer: D

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

85) The unemployment rate rises for a time after a recession is over.

Answer: ☒ True ☐ False

Diff: 3

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

86) Fluctuations in aggregate demand cause structural unemployment.

Answer: True ☒ False

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

87) When the economy is at full employment, everyone who wants a job has a job.

Answer: True ☒ False

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

88) The natural rate of unemployment consists of frictional unemployment plus cyclical unemployment.

Answer: True ☒ False

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

89) Describe the three types of unemployment.

Answer: Cyclical unemployment is caused by a business cycle contraction or recession.

Frictional unemployment is short-term unemployment that arises from the process of matching workers with jobs. Structural unemployment arises from a persistent mismatch between the skills and attributes of workers and the requirements of jobs.

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

90) Why is frictional unemployment unavoidable?

Answer: Frictional unemployment is short-term unemployment arising from the process of matching jobs with workers. There will always be school and tertiary graduates looking for their first job, people re-entering the workforce after a period of absence and people changing jobs. Therefore, there will always be some frictional unemployment.

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

91) Explain what economists mean by 'full employment' and why the associated rate of unemployment is not zero.

Answer: Full employment occurs in the economy when cyclical unemployment is zero. The full-employment rate of unemployment is then made up of the frictional rate of unemployment and the structural rate of unemployment. Since it will always take time to find a job, frictional unemployment will never be zero. Also, since demand and technology are constantly changing in an economy, structural unemployment will never be zero. Workers will lose jobs as the demand for the products they create drops, and therefore become structurally unemployed.

Diff: 3

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

92) What is the natural rate of unemployment, and what types of unemployment constitute the natural rate of unemployment?

Answer: The natural rate of unemployment is thought of as the normal rate of unemployment that would exist in the economy if cyclical unemployment was eliminated. The normal underlying level of unemployment in the economy is made up of frictional and structural unemployment. The natural rate of unemployment is also known as the full-employment rate of unemployment.

Diff: 1

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

93) What is the non-accelerating inflation rate of unemployment (NAIRU)?

Answer: This is the level of unemployment below which the rate of inflation will rise. If unemployment levels fall below the NAIRU, there may be upward pressure on inflation.

Diff: 2

A-Head 13.3: Types of Unemployment

AACSB: Analytic thinking

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

94) By offering training to workers whose firms sacked them because of competition from foreign firms, the federal government is attempting to reduce

- A) frictional unemployment.
- B) structural unemployment.
- C) cyclical unemployment.
- D) seasonal unemployment.

Answer: B

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

95) Which of the following is most likely to reduce structural unemployment?

- A) Lowering interest rates to stimulate investment.
- B) Advertising job opportunities on the internet to improve communication between employers and job seekers.
- C) Reducing unemployment benefits for workers who do not actively seek employment.
- D) The establishment of vocational training centres to help unemployed people learn marketable skills.

Answer: D

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Application of knowledge

96) Establishing employment agencies that speed up the process of matching unemployed workers with unfilled jobs is an attempt to lower

- A) frictional unemployment.
- B) structural unemployment.
- C) cyclical unemployment.
- D) seasonal unemployment.

Answer: A

Diff: 1

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Application of knowledge

97) Unemployment benefits paid to the unemployed

- A) increase the amount of time the unemployed spend searching for a job.
- B) increase the level of frictional unemployment.
- C) help the unemployed maintain their income and spending.
- D) All of these options are correct.

Answer: D

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

98) During the 1990s through to the mid-2000s, the Australian labour market

- A) was deregulated by the government.
- B) was re-regulated by the government.
- C) experienced an increase in union participation rates.
- D) abolished enterprise bargaining.

Answer: A

Diff: 1

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

99) Enterprise bargaining is the negotiation of wages and working conditions

- A) between trade unions and the government.
- B) at the workplace level.
- C) between employers and the government.
- D) through the compulsory arbitration system.

Answer: B

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

100) Which of the following is *not* an advantage of labour market deregulation?

- A) Improved work practices can lead to higher wages.
- B) Wages can more readily respond to changes in the demand for and supply of labour.
- C) Increased labour market flexibility may disadvantage low-paid people.
- D) It can encourage dispute resolution at the workplace level.

Answer: C

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

101) Minimum wage laws cause unemployment because the legal minimum wage is set

- A) below the market wage, causing labour demand to be greater than labour supply.
- B) below the market wage, causing labour demand to be less than labour supply.
- C) above the market wage, causing labour demand to be greater than labour supply.
- D) above the market wage, causing labour demand to be less than labour supply.

Answer: D

Diff: 3

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

102) Trade union membership in Australia in 2014 comprised approximately

- A) 90 per cent of the workforce.
- B) 50 per cent of the workforce.
- C) 15 per cent of the workforce.
- D) 18 per cent of the workforce.

Answer: D

Diff: 1

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

103) Trade unions cause unemployment because the union contract wage is set

- A) below the market wage, causing a shortage of labour.
- B) below the market wage, causing a surplus of labour.
- C) above the market wage, causing a surplus of labour.
- D) above the market wage, causing a shortage of labour.

Answer: C

Diff: 3

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

104) An efficiency wage is

- A) higher than the market wage and tends to increase productivity.
- B) lower than the market wage and tends to increase productivity.
- C) higher than the market wage and tends to decrease productivity.
- D) lower than the market wage and tends to decrease productivity.

Answer: A

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

105) Which of the following has a tendency to raise the unemployment rate?

- A) Implementing a minimum wage in an economy.
- B) Firms deciding to pay efficiency wages in an economy.
- C) The establishment of effective trade unions in an economy.
- D) All of these options are correct.

Answer: D

Diff: 1

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

106) Why might firms pay wages that are above the equilibrium wage in a market?

- A) To increase the productivity of their workers.
- B) To reduce the unemployment rate.
- C) To encourage workers to form trade unions.

D) To reduce profit.

Answer: A

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

107) Efficiency wages cause unemployment because firms pay wages that are

A) below the market wage, causing labour demand to be greater than labour supply.

B) below the market wage, causing labour demand to be less than labour supply.

C) above the market wage, causing labour demand to be greater than labour supply.

D) above the market wage, causing labour demand to be less than labour supply.

Answer: D

Diff: 3

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

108) Eliminating structural unemployment would be good for the economy.

Answer: True ☒ False

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

109) Unemployment benefits reduce the opportunity cost of job search.

Answer: ☒ True ☐ False

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

110) Most economists agree that trade unions reduce the overall unemployment rate in the economy.

Answer: True ☒ False

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

111) Paying efficiency wages is a way for a company to cut costs and become more efficient, and they are therefore lower than market wages.

Answer: True ☒ False

Diff: 1

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

112) What effect do unemployment benefits have on job search?

Answer: Unemployment benefits provide some income for unemployed people, enabling them to spend more time searching for a job. In Australia, there are no limits on the length of time people can continue to receive unemployment benefits. However, some countries, such as the United States of America, do have limits on the period of time a person can receive unemployment payments.

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

113) What effect does the payment of government unemployment benefits have on the unemployment rate?

Answer: The payment of government unemployment benefits likely raises the unemployment rate. The unemployment

benefit payment lowers the opportunity cost (the salary that the unemployed are giving up by not working) of continuing to search for a job, which leads the unemployed to spend more time searching for a job.

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

114) Explain the three main types of unemployment and outline the types of policies that can be used to reduce each type.

Answer: There are three main types of unemployment: frictional, structural and cyclical. Cyclical unemployment (also known as demand-deficient unemployment) occurs when the economy moves into an economic contraction or recession. Many firms find their sales falling, reduce production levels, and therefore do not require as many workers. Expansionary fiscal and monetary policies can be used to try to reduce cyclical unemployment (see Chapters 16 and 17) and effective stabilisation policy may be able to prevent a recession from occurring.

Frictional unemployment is short-term unemployment that arises from the process of matching workers with jobs. The process of job search takes time, so there will always be some workers who are frictionally unemployed because they are between jobs and in the process of searching for new ones. It also arises due to people entering the workforce for the first time, such as school leavers and college and university graduates, together with people re-entering the workforce after a period of absence (perhaps due to having children). Policies that can reduce frictional unemployment focus on improving the efficiency of the job-search process, such as more efficient job search agencies. Job Services Australia is the result of a policy designed to do this. Greater use of the internet by job agencies has also improved information flows.

Structural unemployment arises from a persistent mismatch between the skills or attributes of workers and the requirements of jobs. Structural unemployment can last for long periods because workers need time to learn new skills, and some may never learn these. In Australia, the percentage of workers in manual jobs has been declining over several decades with the decline in the manufacturing sector and increases in productivity in other 'industrial' areas such as utilities, telecommunications and agriculture. While some retrain, others have been unable to find alternative work; particularly older men, since the skills in new jobs that have been created in the service sector do not match theirs. Some workers lack even basic skills, such as literacy, or have addictions to drugs or alcohol that make it difficult for them to perform adequately the duties of almost any job. These workers may remain structurally unemployed for years. Retraining programs and apprenticeship sponsorship by the government can help reduce structural unemployment or prevent it from increasing.

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Application of knowledge

115) Discuss the likely impact of each of the following on the unemployment rate:

- The length of time workers are eligible to receive unemployment benefit payments is reduced.
- The government passes a law making trade unions illegal.
- The minimum wage is raised by 50 per cent.
- The government funds an Internet site where companies can post job openings at no charge.

Answer:

- The unemployment rate will likely decrease, since decreasing the time people are eligible to receive unemployment benefits will increase the opportunity cost of searching for a job.
- The unemployment rate will likely decrease, since companies will no longer have to pay above-market union wages and will be able to afford to hire more workers.
- The unemployment rate will likely increase, since an increase in minimum wage will raise the wage above the market wage for some workers.
- The unemployment rate will likely decrease, since making information on job openings more available reduces the search time involved in frictional unemployment.

Diff: 3

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Application of knowledge

116) Who might be disadvantaged by deregulation of the labour market?

Answer: Deregulation of the labour market can include individual bargaining. People who are low-skilled will be in the

weakest position to bargain for wages and working conditions. Therefore, deregulation without a 'safety net' such as minimum wages and working conditions laws would likely disadvantage the low-skilled, low-paid people in the workforce.

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

117) Why would a firm pay efficiency wages?

Answer: An efficiency wage is a wage that is higher than the market wage and is paid by a firm to raise productivity. Studies show that workers are motivated to work harder if they are paid higher wages. A firm does not have to monitor the worker as closely to get them to be more productive because the higher wage motivates them to be productive.

Diff: 2

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

118) Explain the changes that have occurred in the level of regulation in the Australian labour market over the past 100 years, and discuss the arguments in favour of and against these changes.

Answer: Australia has moved from a highly centralised wages and industrial relations system to an increasingly decentralised system. A complex system of award wages and working conditions and interlocking Commonwealth and State government legislation has been removed or revised, with the goal of increasing labour market flexibility. This flexibility was reduced in 2008 with the government re-regulating some areas of the labour market. In 1991, the Australian Industrial Relations Commission (AIRC) encouraged workers and their employers to bargain directly with each other at the enterprise level—known as enterprise bargaining. Enterprise bargaining was given a further stimulus by the 1993 *Industrial Relations Act* which came into force in 1994. By 2006, about one-half of all employees in the federal jurisdiction were covered by an enterprise agreement. In 2006, the government enacted legislation known as *WorkChoices*, which introduced significant changes to the workplace relations system to further deregulate labour markets. With the change in government in 2007, this legislation was repealed in 2008.

Those in favour of deregulation argue that it leads to increased employment and economic growth. Deregulation allows employers to be more flexible with the wages paid, which means that wages will rise in areas with strong labour demand, sending a signal to workers to supply more labour to those areas. Deregulation also allows for employers to adjust the quantity of hours worked without having to pay significant rates for overtime hours, which leads to some employers closing their businesses on holidays or Sundays as it is not profitable for them to pay overtime. It has also been argued by some economists that minimum wages reduce employment for unskilled or low-skilled workers. Further, proponents of deregulation argue that workplace disputes are more easily solved at the workplace level.

Those against deregulation argue that while it can lead to higher wages for the skilled workforce, it can lead to lower wages and poorer working conditions for the low-skilled or unskilled. Unskilled labour is highly substitutable, and such workers are therefore not in a position to bargain for improved wages or conditions. This also leads to issues of equity in society. Further, those against full deregulation of the labour market argue that minimum wage legislation is necessary to protect the low-skilled from being paid at rates that are too low to support a reasonable standard of living.

Diff: 3

A-Head 13.4: Explaining Frictional and Structural Unemployment

AACSB: Analytic thinking

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

119) Inflation occurs when the

- A) value of money is rising.
- B) general price level is rising.
- C) value of real GDP increases.
- D) value of real GDP decreases.

Answer: B

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking



- 120) Inflation is an increase in the
- A) overall level of economic activity.
  - B) rate of growth of GDP.
  - C) average hourly wage rate.
  - D) general price level in the economy.

Answer: D

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 121) Which of the following is a correct description of inflation?
- A) Inflation refers to an increase in relative prices throughout the economy.
  - B) Inflation is the change in the price level from one year to another.
  - C) Inflation is a sustained increase in the price level.
  - D) Inflation is when there is a one-time jump in the price level.

Answer: C

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 122) The inflation rate is measured as the
- A) percentage change in the relevant price index from one time period to another.
  - B) change in the price level between two time periods, multiplied by 100.
  - C) percentage change in prices in time period 1 minus the percentage change in prices in time period 2, multiplied by 100.
  - D) price index in time period 2 minus the price index in time period 1.

Answer: A

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 123) The broadest measure of the price level which includes all final goods and services is the
- A) producer price index.
  - B) consumer price index.
  - C) GDP deflator.
  - D) wholesale price index.

Answer: C

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 124) The most widely used measure of inflation is based on which of the following price indices?
- A) The producer price index.
  - B) The consumer price index.
  - C) The GDP deflator.
  - D) The wholesale price index.

Answer: B

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 125) Which of the following is the smallest portion of the market basket of goods that makes up the CPI?
- A) Housing
  - B) Clothing and footwear
  - C) Transportation



D) Education

Answer: D

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

126) Which of the following is the largest portion of the market basket of goods that makes up the CPI?

A) Housing

B) Clothing and footwear

C) Health

D) Communication

Answer: A

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

127) The formula for calculating the CPI is

A)  $(\text{Expenditures in the current year} / \text{Expenditures in the base year}) \times 100$ .

B)  $(\text{Expenditures in the current year} \times \text{Expenditures in the base year}) / 100$ .

C)  $(\text{Expenditures in the base year} / \text{Expenditures in the current year})$ .

D)  $(\text{Expenditures in the base year} \times 100) / (\text{Expenditures in the current year})$ .

Answer: A

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

128) Suppose an economy has only three goods, and the typical family purchases the amounts given in the following table. If 2005 is the base year, then what is the CPI for 2012?

Product	Quantity (2005)	Price (2005)	Expenditures (2005)	Price (2012)	Expenditures (on base year quantities) (2012)
Computers	1	\$1700	\$1700	\$1200	\$1200
Books	10	\$25	\$250	\$30	\$300
Burgers	50	\$1.00	\$50	\$2.00	\$100
Total			\$2000		\$1600

A) 80

B) 125

C) 200

D) 160

Answer: A

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

129) Suppose an economy has only three goods and the typical family purchases the amounts given in the following table. If 2005 is the base year, then what is the CPI for 2013?

Product	Quantity (2005)	Price (2005)	Expenditures (2005)	Price (2013)	Expenditures (on base year quantities) (2013)
Hair cuts	6	\$50	\$300	\$70	\$420
Backpacks	4	\$25	\$100	\$30	\$120
Tacos	100	\$1.00	\$100	\$5.00	\$500

Total			\$500		\$1040
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- A) 180
- B) 208
- C) 40.08
- D) 100

Answer: B

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

130) Suppose that the data in the following table reflects the prices in the economy. What is the inflation rate between 2013 and 2014?

Year	CPI (1990 = 100)
2013	175
2014	180

- A) 5 per cent
- B) 2.9 per cent
- C) 4.6 per cent
- D) 7.5 per cent

Answer: B

Diff: 3

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

131) Suppose that the data in the following table reflects the prices in an economy. What is the inflation rate between 2012 and 2013?

Year	CPI (2012 = 100)
2012	100
2013	120

- A) 2 per cent
- B) 5 per cent
- C) 20 per cent
- D) 10 per cent

Answer: C

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

132) From the data in the following table we can say that the cost of living rose by \_\_\_\_\_ between 2012 and 2013.

Year	CPI (2012 = 100)
2012	100
2013	113

- A) 2 per cent

- B) 5 per cent
- C) 8 per cent
- D) 13 per cent

Answer: D

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

133) Weekly expenditures for a family of four in 2012 averaged \$1400. In 2013, the cost of the same purchases was \$1500. If 2012 is the base year, what was the CPI in 2013?

- A) 110
- B) 107
- C) 100
- D) 93

Answer: B

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

134) If the CPI changes from 125 to 120 between 2013 and 2014, how did prices change between 2013 and 2014?

- A) Prices increased by 5 per cent.
- B) Prices decreased by 5 per cent.
- C) Prices increased by 25 per cent.
- D) Prices decreased by 4 per cent.

Answer: D

Diff: 3

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

135) If the CPI rises from 206.7 to 212.7 between two consecutive years, by how much has the cost of living changed between these two years?

- A) The cost of living has increased by 6 per cent.
- B) The cost of living has increased by 2.9 per cent.
- C) The cost of living has increased by 12.7 per cent.
- D) The cost of living has decreased by 6 per cent.

Answer: B

Diff: 3

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

136) Which of the following describes the accuracy of the Consumer Price Index (CPI)?

- A) Changes in the CPI accurately reflect the true rate of inflation.
- B) Changes in the CPI understate the true rate of inflation.
- C) Changes in the CPI overstate the true rate of inflation.
- D) Changes in the CPI are unrelated to the true rate of inflation.

Answer: C

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

137) If consumers purchase fewer of those products that increase most in price and more of those products that decrease in price as compared to the CPI basket, then changes in the CPI

- A) accurately reflect the true rate of inflation.
- B) understate the true rate of inflation.

- C) overstate the true rate of inflation.
- D) are unrelated to the true rate of inflation.

Answer: C

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

138) When the price of petrol rises, some consumers begin riding their bikes more frequently or taking public transport instead of driving their cars. The fact that the CPI does not fully account for such changes in consumer behaviour is called

- A) outlet bias.
- B) increase in quality bias.
- C) substitution bias.
- D) discrimination bias.

Answer: C

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

139) Assume that the base period for CPI calculations is 1980. In Australia in 2011, around 24 per cent of people accessed the internet through a broadband connection that did not exist in the 1980s. This potential for bias in the CPI is referred to as \_\_\_\_\_ bias and results in \_\_\_\_\_.

- A) outlet; the CPI underestimating the true change in the cost of living
- B) new product; the CPI overestimating the true change in the cost of living
- C) outlet; the CPI overestimating the true change in the cost of living
- D) new product; the CPI underestimating the true change in the cost of living

Answer: B

Diff: 3

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

140) What is outlet bias?

- A) The tendency for households to spend more money over time.
- B) The tendency for households to spend their money at discount stores as prices rise.
- C) The tendency for the quality of products to improve over time, even though the CPI does not measure changes in quality.
- D) The tendency for consumers to purchase newer, more technologically advanced products even though they have higher prices.

Answer: B

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

141) In 1986, an Apple IIe computer with 65 kilobytes of memory cost around \$1500. Today, a \$1500 iMac computer (also made by Apple) comes with 4 gigabytes of memory. This illustrates the potential for what kind of bias in CPI calculations?

- A) New product bias.
- B) Increase in quality bias.
- C) Substitution bias.
- D) Outlet bias.

Answer: B

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

- 142) The PPI is the
- A) price parity index.
  - B) prime producer index.
  - C) producer price index.
  - D) production performance indicator.

Answer: C

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 143) What does the producer price index (PPI) measure?

- A) The average change in the prices paid for all goods produced in the economy over a given year.
- B) The average of the prices received by producers of goods and services at all stages of the production process.
- C) The level of production of goods and services generated in the economy in a given year.
- D) The difference between the prices consumers pay for goods and services and the prices producers pay for goods and services.

Answer: B

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 144) The GDP deflator includes the price changes of all newly produced goods and services while the consumer price index only includes the price changes of some newly produced goods and services.

Answer: ☒ True ☐ False

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 145) The inflation rate measures the percentage increase in the price level from one year to the next.

Answer: ☒ True ☐ False

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

- 146) If the CPI falls from 142 to 140 between two consecutive years, this implies that prices fell by 2 per cent between those two years.

Answer: ☐ True ☒ False

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

- 147) The producer price index tracks the prices firms receive for goods and services at all stages of production.

Answer: ☒ True ☐ False

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

- 148) Explain the difference between the price level, inflation and the inflation rate.

Answer: The price level is a measure of the average prices of goods and services in the economy. A sustained increase in the general price level of the economy is called inflation. The inflation rate is the percentage increase in the general price level of the economy from one period of time to the next, usually expressed annually.

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

149) How many broad categories of goods and services are in the CPI market basket, and which three largest groups comprise almost half of the market basket?

Answer: There are 11 broad categories of goods and services in the CPI market basket. Almost half of the market basket comprises housing, transportation and food.

Diff: 1

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

150) List three different price indices and explain how they differ in terms of the market basket on which they are based.

Answer: Three examples of price indices are the GDP deflator, the consumer price index, and the producer price index. All three differ by the kinds of goods that are contained in the market basket that is used to calculate the average level of prices. The GDP deflator is based on the average price of all final goods and services produced in the economy. The consumer price index is based on the average price of consumer goods and services purchased by households. The producer price index is based on the prices received by producers of goods and services at all stages of the production process.

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

151) If a disease affected apple trees in Australia and significantly reduced the availability of apples for a year, what affect would this have on the CPI and would using the CPI to calculate the rate of inflation produce an accurate representation of the rate of inflation in that year?

Answer: Disease affecting apple trees that significantly reduced the supply of apples would lead to a large price increase of apples. As apples are commonly purchased, they are an important component of the CPI market basket. Therefore, the CPI would rise substantially, indicating an increase in the rate of inflation that year. However, it is unlikely that people would continue to purchase the same quantities of apples if they were very expensive, and would instead substitute other fruit for apples. Therefore the prices of the goods that consumers actually buy would rise by less than the prices in the CPI market basket.

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

152) Consider a simple economy that produces only three products: hot dogs, torches and golf balls. Use the information in the following table to calculate the inflation rate for 2014, as measured by the consumer price index.

Product	Quantity	Base Year Price (2005)	Price (2013)	Price (2014)
Hot dogs	10	\$1.00	\$1.50	\$1.75
Torches	15	\$5.00	\$7.00	\$6.75
Golf balls	8	\$2.00	\$3.00	\$3.50

Answer: Total expenditures for 2005 =  $(10 \times \$1.00) + (15 \times \$5.00) + (8 \times \$2.00) = \$101.00$ .

Total expenditures for 2013 =  $(10 \times \$1.50) + (15 \times \$7.00) + (8 \times \$3.00) = \$144.00$ .

Total expenditures for 2014 =  $(10 \times \$1.75) + (15 \times \$6.75) + (8 \times \$3.50) = \$146.75$ .

The CPI for 2013 =  $[(\$144.00/\$101.00) \times 100] = 142.57$ .

The CPI for 2014 =  $[(\$146.75/\$101.00) \times 100] = 145.30$ .

So, the inflation rate for 2014 =  $[(145.30 - 142.57)/142.57] \times 100 = 1.9$  per cent.

Diff: 3

A-Head 13.5: Measuring Inflation

AACSB: Application of knowledge

153) Explain how the CPI is constructed, and discuss any weaknesses with this measurement technique.

Answer: The Australian Bureau of Statistics (ABS) surveys a sample of households in the eight capital cities to determine their spending habits and to construct a listing or market basket of these goods. The survey is also used to determine the importance of the items in the consumer's budget. Each month, the ABS collects the prices of the goods in the market basket from various capital city stores. A weighted average is taken of those prices, with the more important items receiving higher weights. A base year is chosen and the CPI is set to 100 in the base year. In every other year, the CPI is calculated as the ratio of the cost of the market basket in that year, divided by the cost of the market basket in the base year, multiplied by 100.

The CPI does not always produce an entirely accurate measure of prices in the economy. Possible problems include: substitution bias—where people stop buying some goods and services when their prices rise significantly (buying substitutes instead), but the CPI market basket still bases its estimates on the same quantity and types of purchases; increase in quality bias—where price increases may be due to quality increases; new product bias—the CPI market basket is only revised every five years or so, and may therefore contain products that are no longer commonly purchased or may not contain commonly purchased new products; and outlet bias—where people buy goods and services from retailers outside of the capital cities, at discount stores, or via the internet.

Diff: 2

A-Head 13.5: Measuring Inflation

AACSB: Analytic thinking

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

154) If nominal wages rise faster than the price level, then real wages have \_\_\_\_\_ and the purchasing power of income has \_\_\_\_\_.

- A) fallen; fallen
- B) fallen; risen
- C) risen; risen
- D) risen; fallen

Answer: C

Diff: 2

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Analytic thinking

155) If nominal wages rise slower than the price level, then real wages have \_\_\_\_\_ and the purchasing power of income has \_\_\_\_\_.

- A) fallen; fallen
- B) fallen; risen
- C) risen; risen
- D) risen; fallen

Answer: A

Diff: 2

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Analytic thinking

156) Looking at the following table, real wages \_\_\_\_\_ from 2011 to 2012 and real wages \_\_\_\_\_ from 2012 to 2013.

Year	Nominal Average Hourly Earnings, \$	CPI (2011 = 100)
2011	10	100
2012	10	105
2013	12	110

- A) rose; rose
- B) rose; fell
- C) fell; rose

D) fell; fell

Answer: C

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

157) Looking at the following table, real average hourly earnings equals \_\_\_\_\_ in 2012.

Year	Nominal Average Hourly Earnings, \$	CPI (2012 = 100)
2012	10	100
2013	10	105
2014	12	110

A) \$9.52

B) \$9.00

C) \$10.00

D) \$12.00

Answer: C

Diff: 2

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

158) Assume that between 2012 and 2013, the CPI of a country rose from 182 to 185. If household incomes rose by 3 per cent during that period of time, then which of the following is *true*?

A) The purchasing power of household income rose between 2012 and 2013.

B) The purchasing power of household income fell between 2012 and 2013.

C) The purchasing power of household income remained constant between 2012 and 2013.

D) The CPI cannot be used to determine how the purchasing power of household income changes over time.

Answer: A

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

159) Looking at the following table, real average hourly earnings equal \_\_\_\_\_ in 2011.

Year	Nominal Average Hourly Earnings, \$	CPI (2010 = 100)
2010	10	100
2011	10	105
2012	12	110

A) \$9.52

B) \$9.00

C) \$10.00

D) \$12.00

Answer: A

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

160) Looking at the following table, what is the rate of growth of real average hourly earnings from 2010 to 2011?



Year	Nominal Average Hourly Earnings, \$	CPI (2010 = 100)
2010	10	100
2011	10	105
2012	12	110

- A) 5 per cent
- B) -5 per cent
- C) 15 per cent
- D) -15 per cent

Answer: B

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

161) Looking at the following table, what is the rate of growth of the average price level from 2010 to 2011?

Year	Nominal Average Hourly Earnings, \$	CPI (2010 = 100)
2010	10	100
2011	10	105
2012	12	110

- A) 1 per cent
- B) 2 per cent
- C) 3 per cent
- D) 5 per cent

Answer: D

Diff: 2

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

162) Looking at the following table, what is the rate of growth of the average price level from 2011 to 2012?

Year	Nominal Average Hourly Earnings, \$	CPI (2010 = 100)
2010	10	100
2011	10	105
2012	12	110

- A) 1.52 per cent
- B) 2.0 per cent
- C) 3.5 per cent
- D) 4.76 per cent

Answer: D

Diff: 2

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

163) If the anticipated rate of inflation is 5 per cent and workers agree to a wage increase of 4 per cent, if the anticipated rate occurs, then nominal wages will

- A) fall by 1 per cent.
- B) rise by 4 per cent.

C) rise by 5 per cent.

D) fall by 5 per cent.

Answer: B

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

**TRUE/FALSE.** Write 'T' if the statement is true and 'F' if the statement is false.

164) To calculate real wages in Year 1, it is correct to divide nominal wages in Year 1 by the CPI in year 1, and multiply the resultant figure by 100.

Answer: ☒ True ☐ False

Diff: 1

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Analytic thinking

165) Assume that the CPI in 2014 was 217, while the CPI in 1986 was 82. If a person had \$5000 in 1986, its equivalent purchasing power in 2014 would be \$10 850.

Answer: ☐ True ☒ False

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

**ESSAY.** Write your answer in the space provided or on a separate sheet of paper.

166) Using the following table, calculate real average hourly earnings for 2012, 2013 and 2014. Calculate the rate of growth of real average hourly earnings from 2013 to 2014.

Year	Nominal Average Hourly Earnings, \$	CPI (2012 = 100)
2012	10	100
2013	11	105
2014	12	110

Answer: Real average hourly earnings in 2012 are  $\left[ \frac{\$10}{100} \right] \times 100 = \$10$ .

Real average hourly earnings in 2013 are  $\left[ \frac{\$11}{105} \right] \times 100 = \$10.48$ .

Real average hourly earnings in 2014 are  $\left[ \frac{\$12}{110} \right] \times 100 = \$10.91$ .

The rate of growth of real average hourly earnings from 2013 to 2014 is

$$\left[ \frac{\$10.91 - \$10.48}{10.48} \right] \times 100 = 4.103 \text{ per cent}$$

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

167) Using the following table, calculate the real average wage for 1993 and 2013. Calculate the rate of growth of real average wages from 1993 to 2013. Are workers in this country better off in terms of the purchasing power of a dollar in 1993 or 2013? Explain why.

Year	Nominal average wage, \$	CPI (2005 = 100)
------	-----------------------------	---------------------

1993	2.00	49.3
2013	6.00	190.2

Answer: The real average wage in 1993 is  $\left[ \frac{\$2}{49.3} \right] \times 100 = \$4.06$ .

The real average wage in 2013 is  $\left[ \frac{\$6}{190.2} \right] \times 100 = \$3.15$ .

The rate of growth of the real wage from 1993 to 2013 is  $\left[ \frac{\$3.15 - \$4.06}{\$4.06} \right] \times 100 = -22 \text{ per cent}$

Workers who earned wages were better off in 1993 as compared to 2013. The value of the average wage was higher in 1993. It has declined by 22 per cent from 1993 to 2013.

Diff: 3

A-Head 13.6: Using Price Indexes to Adjust for the Effects of Inflation

AACSB: Application of knowledge

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

168) Which of the following is *not* generally a cost posed by inflation?

- A) Inflation reduces the affordability of goods and services for the average consumer.
- B) Consumers and firms lose purchasing power to the extent that money loses value.
- C) Firms must pay for changing prices on products and printing new catalogues.
- D) Banks can lose if they under-predict inflation and charge an interest rate that does not completely compensate for inflation.

Answer: A

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

169) Which of the following do *not* suffer the costs of inflation?

- A) People on fixed incomes.
- B) People whose incomes rise more rapidly than inflation.
- C) Firms that have to devote more time and labour to raising prices.
- D) An investor that has to pay higher taxes because of the inflation.

Answer: B

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

170) High anticipated inflation will cause

- A) real wages to fall.
- B) real interest rates to fall.
- C) no change in real interest rates.
- D) real wages to rise.

Answer: C

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

171) Which of the following statements is *false*?

- A) Whether you gain or lose during a period of inflation depends on whether your income rises faster or slower than the prices of things you buy.
- B) Inflation that is higher than expected benefits debtors, and inflation that is lower than expected benefits creditors.

C) When unanticipated inflation occurs regularly, the degree of risk associated with investments in the economy increases.

D) There are no costs or losses associated with inflation when it is fully anticipated.

Answer: D

Diff: 3

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

172) If inflation is completely anticipated

A) no-one loses.

B) borrowers lose.

C) lenders lose.

D) firms lose because they incur menu costs.

Answer: D

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

173) The cost to firms of changing prices is called

A) redistribution costs.

B) menu costs.

C) anticipation costs.

D) money illusion costs.

Answer: B

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

174) What are menu costs?

A) The full list of a firm's costs of production.

B) The costs to a firm of changing prices.

C) The cost to a household of borrowing money when there is deflation.

D) The opportunity cost of dining in a restaurant instead of at home.

Answer: B

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

175) Which of the following statements is *true*?

A) When unanticipated inflation occurs regularly, the degree of risk associated with investments in the economy decreases.

B) Inflation that is higher than expected benefits debtors, and inflation that is lower than expected benefits creditors.

C) Inflation improves the balance of trade as exports appear relatively cheaper to overseas buyers and imports become relatively more expensive.

D) There are no costs or losses associated with inflation when it is fully anticipated.

Answer: B

Diff: 3

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

176) Which of the following is *not* an economic cost of higher than anticipated inflation?

A) Purchasing power of people on fixed incomes will fall.

B) A person who has borrowed money at a fixed interest rate will be disadvantaged.

C) Businesses incur costs through having to change prices.

D) Banks who have loaned out money at a fixed interest rate will be disadvantaged.

Answer: B

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Application of knowledge

177) If inflation increases unexpectedly, then

A) borrowers lose.

B) lenders lose.

C) lenders gain and borrowers gain.

D) neither borrowers nor lenders lose.

Answer: B

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

178) Which of the following individuals would be most negatively affected by anticipated inflation?

A) A retired railway engineer who receives a fixed income payment every month.

B) A union contractor whose pay is adjusted based on changes in the CPI.

C) A full-time employee at a pizza shop who earns more than the minimum wage.

D) A student who borrows \$10 000 at a nominal interest rate of 5 per cent to finance educational expenses.

Answer: A

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Application of knowledge

179) Inflation that is \_\_\_\_\_ than what is expected benefits \_\_\_\_\_ and hurts \_\_\_\_\_.

A) less; lenders; borrowers

B) less; borrowers; lenders

C) greater; lenders; borrowers

D) greater; lenders; no-one

Answer: A

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

180) Which of the following is *not* true about hyperinflation?

A) During times of hyperinflation, people try to avoid holding cash.

B) Economies with hyperinflation are usually in a severe recession.

C) Hyperinflation occurs during times of economic boom.

D) During times of hyperinflation, the rate of inflation can be millions of per cent per month.

Answer: C

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

181) Which of the following causes 'hyperinflation'?

A) A shortage of credit, similar to that which occurred during the 2007-2009 global financial crisis.

B) A central bank policy of high interest rates.

C) Government budget surpluses leading to an increase in government spending.

D) Central bank activity which increases financial liquidity at a much greater rate than the growth rate of real GDP.

Answer: D

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Application of knowledge

- 182) Deflation occurs when there is a
- A) sustained increase in the price level.
  - B) one-time increase in the price level.
  - C) sustained decline in the price level.
  - D) one-time decrease in the price level.

Answer: C

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

- 183) Which of the following is *not* a potential problem of deflation?

- A) Debt burdens may rise as prices fall.
- B) Asset values will fall.
- C) Unemployment rates may rise.
- D) Expectations of future price falls may cause a rise in aggregate demand.

Answer: D

Diff: 3

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Application of knowledge

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

- 184) The problem with inflation is that as prices rise most consumers can no longer afford to buy as many goods and services.

Answer: True ☒ False

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

- 185) There are no costs to inflation if it is fully anticipated.

Answer: True ☒ False

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

- 186) Anticipated inflation increases the amount of taxation paid by firms and individuals.

Answer: ☒ True False

Diff: 3

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

- 187) Inflation redistributes income to a greater extent when the inflation is unanticipated.

Answer: ☒ True False

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

- 188) Hyperinflation occurred in Germany after World War I, when its inflation rate rose to 3.25 million per cent.

Answer: ☒ True False

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

- 189) Hyperinflation is caused by a country's central bank when it reduces liquidity, thereby creating a shortage of money,

leading to inflation.

Answer: True ☒ False

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

190) Deflation occurs when the price level becomes negative.

Answer: True ☒ False

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

191) During times of deflation, borrowers of money can lose, as their debt burden increases.

Answer: ☒ True False

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

192) Does inflation mean that consumers can no longer afford to buy as many goods and services due to the higher prices? Explain.

Answer: No, inflation does not mean that consumers can no longer afford to buy as many goods and services, as nominal incomes generally increase with inflation. Therefore goods and services for the average consumer will be just as affordable. Exceptions to this are people on fixed incomes, or people who are unable to bargain for nominal wage increases sufficient to keep up with inflation.

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

193) Explain why you would rather be a borrower during a period of unexpected rising inflation and a lender during a period of unexpected declining inflation.

Answer: The nominal interest rate includes a charge to compensate the lender for the loss in purchasing power that results from inflation. This is called an 'inflation premium' and is equal to the amount of inflation that the lender expects over the period of a loan. If inflation unexpectedly rises, the lender is not compensated enough for the loss in purchasing power. Likewise, the borrower pays too little to compensate the lender for inflation. So it is better to be a borrower in times of unexpected rising inflation.

When inflation unexpectedly falls, then the lender is compensated too much for inflation as the inflation premium is higher than actual inflation. The borrower likewise pays too much for inflation. So it is better to be a lender than a borrower during a period of unexpected declining inflation.

Diff: 3

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

194) Describe how inflation can be costly even if it is anticipated.

Answer: First, there will be redistribution as some people's incomes fall behind even an anticipated level of inflation. Second, firms and individuals must hold money to perform transactions. Those people holding money will lose purchasing power at a rate equal to inflation. Third, firms must pay individuals to change prices. These costs are called 'menu costs,' and can be substantial at very high levels of inflation. Fourth, investors have to pay higher taxes on interest and capital gains income, as the government taxes nominal interest and capital gains income. Investors then lose real after-tax income. This is similar for individuals paying income tax, as income tax brackets are not regularly adjusted for inflation.

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

195) What is hyperinflation?

Answer: Hyperinflation refers to extremely rapid increases in the general price level. The rate of inflation can exceed thousands or millions of per cent per year. It does not commonly occur, but there are a number of instances of hyperinflation throughout history, and it has also occurred in recent times.

Diff: 1

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

196) What is deflation and what effect does deflation have on borrowers of money and on asset values?

Answer: Deflation is a decline in the general level of prices; that is, the rate of inflation is negative. Deflation increases the debt burden of borrowers, as the value of the money that they pay back is greater than the value when they borrowed it. Deflation causes a decrease in the value of assets.

Diff: 2

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

197) Describe how a lender can lose from inflation if the inflation is unanticipated and the loan is a fixed-interest-rate loan. How would a variable-interest-rate loan (one that adjusts over the contract period) eliminate these losses?

Answer: Lenders require compensation for inflation when charging interest. The nominal interest rate they charge equals the real rate of interest plus the expected inflation over the loan contract period. The interest rate they charge is determined at the beginning of the loan period, so the charge for inflation is a prediction of what the lender thinks inflation will be over the contract period. If the loan has a fixed rate, the interest rate does not change over the period of the loan. If the lender under-predicts inflation, then the lender will not be compensated enough for the loss in purchasing power due to inflation. The lender will lose to the extent of the under-prediction.

If the loan is a variable-rate loan, the interest rate can be adjusted upwards if the lender under-predicts inflation. This can lower the loss to the lender. The variable rate automatically adjusts for mistakes in predicting inflation. The more frequently the rate can be adjusted, the less the lender's losses will be.

Diff: 3

A-Head 13.7: Does Inflation Impose Costs on the Economy?

AACSB: Analytic thinking

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

198) Which of the following can cause demand-pull inflation if the economy is currently in equilibrium at full-employment GDP?

- A) An increase in net exports.
- B) A reduction in government spending.
- C) An increase in the company income tax rate.
- D) A decrease in real wages.

Answer: A

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Application of knowledge

199) Demand-pull inflation is caused by

- A) a recession.
- B) high levels of aggregate demand in the short run.
- C) an increase in the costs of production, which pulls prices higher.
- D) wage increases that are higher than increases in productivity growth.

Answer: B

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking



200) Demand-pull inflation is characterised by

- A) high levels of aggregate demand, which then pull prices down to lower levels.
- B) the short-run aggregate supply curve shifting to the right.
- C) rising prices and rising employment in the short run.
- D) the short-run aggregate supply curve shifting to the left.

Answer: C

Diff: 1

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

201) Cost-push inflation can be caused by

- A) insufficient demand leading to falling profits for producers, therefore, producers have to raise their prices to continue to be profitable.
- B) increases in aggregate supply.
- C) real wage increases that are higher than increases in productivity growth.
- D) very high levels of aggregate demand in the short run.

Answer: C

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

202) Cost-push inflation can be caused by

- A) a high growth rate in real wages.
- B) an increase in aggregate demand, which pushes prices higher.
- C) an increase in aggregate supply, which pushes prices higher.
- D) growth in aggregate demand not keeping up with the growth in aggregate supply.

Answer: A

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

203) Which of the following can cause cost-push inflation if the economy is currently in equilibrium at full-employment GDP?

- A) A flood that destroys much of the country's crops.
- B) An increase in the size of the labour force.
- C) A decrease in personal income tax rates, which increases after-tax income.
- D) An increase in the capital stock in the country.

Answer: A

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Application of knowledge

204) With cost-push inflation, initially

- A) the price level and real GDP both increase.
- B) only real GDP changes while the price level remains constant.
- C) the price level rises and real GDP declines.
- D) All of these options are correct.

Answer: C

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

205) Cost-push inflation is characterised by

- A) very high levels of aggregate demand pushing prices higher.

B) the short-run aggregate supply curve shifting to the right.

C) rising prices and rising unemployment.

D) an increase in the level of nominal wages.

Answer: C

Diff: 1

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

**TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.**

206) If aggregate demand continues to increase when the economy reaches full employment, demand-pull inflation will begin to decelerate.

Answer: True ☒ False

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

207) An increase in real wages shifts the aggregate supply curve to the left, always resulting in cost-push inflation.

Answer: True ☒ False

Diff: 3

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

**ESSAY. Write your answer in the space provided or on a separate sheet of paper.**

208) What is the difference between demand-pull inflation and cost-push inflation?

Answer: Demand-pull inflation is caused by an increase in aggregate demand when production levels are not able to meet this demand. It occurs when the economy is near, at, or beyond full employment. Cost-push inflation is caused by anything that decreases aggregate supply, such as an oil price shock, or an increase in real wages that is greater than the corresponding increase in labour productivity.

Diff: 2

A-Head 13.8: What Causes Inflation?

AACSB: Analytic thinking

- 1) A
- 2) D
- 3) C
- 4) C
- 5) A
- 6) B
- 7) A
- 8) B
- 9) B
- 10) B
- 11) A
- 12) B
- 13) B
- 14) B
- 15) D
- 16) C
- 17) D
- 18) D
- 19) D
- 20) C
- 21) D
- 22) B
- 23) B
- 24) B
- 25) A
- 26) B
- 27) C
- 28) A
- 29) D
- 30) A
- 31) A
- 32) B
- 33) C
- 34) D
- 35) B
- 36) FALSE
- 37) FALSE
- 38) FALSE
- 39) FALSE
- 40) TRUE

41) They are not measured as unemployed as, to be measured as unemployed, a person must be actively looking for work. Discouraged workers have given up looking for work.

42) These individuals would be classified: (i) not in the labour force, (ii) employed, and (iii) not in the labour force.

43) The unemployment rate is calculated as:  $(\text{Number unemployed} / \text{Labour force}) \times 100$

The labour force is the sum of those employed plus the unemployed. This is 180 000 plus 20 000 which equals 200 000 people. Substituting this information into the equation:

$$(20\,000 / 200\,000) \times 100 = 10 \text{ per cent.}$$

44) The labour force participation rate is calculated as:

$$(\text{Labour force} / \text{Working-age population}) \times 100$$

The labour force is the sum of those employed plus the unemployed. This is 180 000 plus 20 000 which equals 200 000 people. The working-age population is the sum of those in the labour force and those not in the labour force but of working age. This is 200 000 plus 50 000 which equals 250 000. Substituting this information into the equation:

$$(200\,000/250\,000) \times 100 = 80 \text{ per cent.}$$

45) The unemployment rate is calculated as:

$$(\text{Number unemployed/Labour force}) \times 100$$

Including discouraged workers would increase the number of people counted as being in the labour force and would increase the number of people counted as unemployed. In terms of the calculation, the numerator would rise, and the denominator would rise. However, the numerator would rise by a greater percentage than the denominator, as the denominator is the sum of employment plus unemployment. If the top number rises more quickly than the bottom number, then the whole number rises. This would increase the unemployment rate.

The labour force participation rate is calculated as:

$$(\text{Labour force/Working-age population}) \times 100$$

Including discouraged workers would increase the number of people in the labour force, but not change the number of people in the working-age population. Increasing the numerator of a fraction increases the fraction. This would, therefore, increase the labour force participation rate because the numerator has increased.

46) The unemployment rate would increase and the labour force participation rate would stay the same. The number of unemployed would rise, but the labour force would stay the same. The part-time workers who wanted to be full-time workers would simply go from being employed to unemployed. With no change in the labour force, the labour force participation rate would not change.

47) Generally, the labour force participation rate has been rising for women and falling for men. Note that the male participation rate rose slightly around the mid-2000s.

48) New jobs are created as technology progresses, consumer tastes change and entrepreneurs successfully create new businesses. Jobs are destroyed due to changes in consumer tastes, new technologies making some jobs redundant, and some entrepreneurs failing in their business ventures.

49) The unemployment rate is measured based on the labour force survey conducted monthly by the Australian Bureau of Statistics (ABS). People are considered to be unemployed if they have not worked for one hour or more in the past week, are currently available to start work, and have been looking for work for the past four weeks. The unemployment rate is then calculated as the number of people unemployed divided by the number of people in the labour force, multiplied by 100. Weaknesses with this method include: it does not take account of under-employment—people who are working less hours than they would like to; it does not include discouraged workers; there may be reasons why people have not been looking for work or are not available to start immediately, but they would still like a job; and some people do not declare that they are working to avoid paying taxation because they are involved in illegal work, or because they are receiving unemployment benefits when they are working and think that telling this to the ABS will cause them to lose their benefits.

50) Overall, the labour force participation rate in Australia has risen significantly over the past 30 years. In particular, female participation rates rose sharply during the 1980s, due to changing social attitudes, federal anti-discrimination legislation, increased wages for women, women having fewer children, and the growth of the services sector (the sector in which females are most highly represented). Between 1978 and 2010, the female participation rate rose from 44 per cent to 58.6 per cent. The participation rate for males has fallen slowly since the late 1970s, from 79 per cent in 1978 to a low of 71.5 per cent in 2004. The general decline over time in male labour force participation rates has been due to younger retirement ages and males staying at school longer. The rate rose slightly between 2004 and 2010 to 72.3 per cent.

51) C

52) A

53) B

- 54) A
- 55) D
- 56) TRUE
- 57) TRUE
- 58) The economic costs of unemployment include loss of GDP, reduced income tax revenue to the government, reductions in firms' profits, the budgetary and opportunity costs of unemployment benefit payments, deterioration of skills of the unemployed, and loss of income to individuals when they become unemployed. Unemployment also has social costs which may include crime, family problems and health problems.
- 59) The groups of people in Australia who are more likely to experience higher levels of unemployment are young people, particularly those aged between 15 and 19 years of age, and people with relatively lower levels of formal education.
- 60) There are significant economic costs due to unemployment. These include forgone GDP—the economy will not be operating on its production possibility frontier; reduced income tax revenue to the government from both personal and company income taxes; reduced GST revenue to the government, as higher unemployment leads to less consumer spending; reductions in firms' profits as higher rates of unemployment lead to lower incomes, which leads to less spending on goods and services; the budgetary and opportunity costs of unemployment benefit payments as, the higher the rate of unemployment, the greater the amount the government must pay in unemployment benefits (funds which could otherwise be used for other purposes); and loss of human capital as, the longer people are unemployed, the more likely their skills will deteriorate or become out of date. Unemployment also imposes serious costs on the unemployed, including loss of income to individuals when they become unemployed (unemployment is one of the main causes of poverty); loss of skills; and loss of confidence. Unemployment also has social costs which may include crime, family problems and health problems.
- 61) A
- 62) B
- 63) C
- 64) B
- 65) C
- 66) A
- 67) C
- 68) D
- 69) D
- 70) D
- 71) B
- 72) D
- 73) A
- 74) B
- 75) A
- 76) C
- 77) C
- 78) B
- 79) D
- 80) C
- 81) B
- 82) D
- 83) C
- 84) D
- 85) TRUE
- 86) FALSE
- 87) FALSE
- 88) FALSE
- 89) Cyclical unemployment is caused by a business cycle contraction or recession.
- Frictional unemployment is short-term unemployment that arises from the process of matching workers with jobs.

Structural unemployment arises from a persistent mismatch between the skills and attributes of workers and the requirements of jobs.

90) Frictional unemployment is short-term unemployment arising from the process of matching jobs with workers. There will always be school and tertiary graduates looking for their first job, people re-entering the workforce after a period of absence, and people changing jobs. Therefore, there will always be some frictional unemployment.

91) Full employment occurs in the economy when cyclical unemployment is zero. The full-employment rate of unemployment is then made up of the frictional rate of unemployment and the structural rate of unemployment. Since it will always take time to find a job, frictional unemployment will never be zero. Also, since demand and technology are constantly changing in an economy, structural unemployment will never be zero. Workers will lose jobs as the demand for the products they create drops, and they will become structurally unemployed.

92) The natural rate of unemployment is thought of as the normal rate of unemployment that would exist in the economy if cyclical unemployment was eliminated. The normal underlying level of unemployment in the economy is made up of frictional and structural unemployment. The natural rate of unemployment is also known as the full-employment rate of unemployment.

93) This is the level of unemployment below which the rate of inflation will rise. If unemployment levels fall below the NAIRU, there may be upward pressure on inflation.

94) B

95) D

96) A

97) D

98) A

99) B

100) C

101) D

102) D

103) C

104) A

105) D

106) A

107) D

108) FALSE

109) TRUE

110) FALSE

111) FALSE

112) Unemployment benefits provide some income for unemployed people, enabling them to spend more time searching for a job. In Australia, there are no limits on the length of time people can continue to receive unemployment benefits.

However, some countries, such as the United States of America, do have limits on the period of time a person can receive unemployment payments.

113) The payment of government unemployment benefits likely raises the unemployment rate. The unemployment benefit payment lowers the opportunity cost (the salary that the unemployed are giving up by not working) of continuing to search for a job, which leads the unemployed to spend more time searching for a job.

114) There are three main types of unemployment: frictional, structural and cyclical. Cyclical unemployment (also known as demand-deficient unemployment) occurs when the economy moves into an economic contraction or recession. Many firms find their sales falling, reduce production levels, and therefore do not require as many workers. Expansionary fiscal and monetary policies can be used to try to reduce cyclical unemployment (see Chapters 16 and 17) and effective stabilisation policy may be able to prevent a recession from occurring.

Frictional unemployment is short-term unemployment that arises from the process of matching workers with jobs. The process of job search takes time, so there will always be some workers who are frictionally unemployed because they are between jobs and in the process of searching for new ones. It also arises due to people entering the workforce for the first time, such as school leavers and college and university graduates, together with people re-entering the workforce after a period of absence (perhaps due to having children). Policies that can reduce frictional unemployment focus on improving the efficiency of the job search process, such as more efficient job search agencies. Job Services Australia is the result of a

policy designed to do this. Greater use of the internet by job agencies has also improved information flows. Structural unemployment arises from a persistent mismatch between the skills or attributes of workers and the requirements of jobs. Structural unemployment can last for long periods because workers need time to learn new skills, and some may never learn these. In Australia, the percentage of workers in manual jobs has been declining over several decades with the decline in the manufacturing sector and increases in productivity in other 'industrial' areas such as utilities, telecommunications and agriculture. While some retrain, others have been unable to find alternative work; particularly older men, since the skills in new jobs that have been created in the service sector do not match theirs. Some workers lack even basic skills, such as literacy, or have addictions to drugs or alcohol that make it difficult for them to perform adequately the duties of almost any job. These workers may remain structurally unemployed for years. Retraining programs and apprenticeship sponsorship by the government can help reduce structural unemployment or prevent it from increasing.

115)

- a. The unemployment rate will likely decrease, since decreasing the time people are eligible to receive unemployment benefits will increase the opportunity cost of searching for a job.
- b. The unemployment rate will likely decrease, since companies will no longer have to pay above-market union wages and will be able to afford to hire more workers.
- c. The unemployment rate will likely increase, since an increase in minimum wage will raise the wage above the market wage for some workers.
- d. The unemployment rate will likely decrease, since making information on job openings more available reduces the search time involved in frictional unemployment.

116) Deregulation of the labour market can include individual bargaining. People who are low-skilled will be in the weakest position to bargain for wage and working conditions. Therefore, deregulation without a 'safety net' such as minimum wages and working conditions laws would likely disadvantage the low-skilled, low-paid people in the workforce.

117) An efficiency wage is a wage that is higher than the market wage and is paid by a firm to raise productivity. Studies show that workers are motivated to work harder if they are paid higher wages. A firm does not have to monitor the worker as closely to get them to be more productive because the higher wage motivates them to be productive.

118) Australia has moved from a highly centralised wages and industrial relations system to an increasingly decentralised system. A complex system of award wages and working conditions and interlocking Commonwealth and State government legislation has been removed or revised, with the goal of increasing labour market flexibility. This flexibility was reduced in 2008 with the government re-regulating some areas of the labour market. In 1991, the Australian Industrial Relations Commission (AIRC) encouraged workers and their employers to bargain directly with each other at the enterprise level; known as enterprise bargaining. Enterprise bargaining was given a further stimulus by the 1993 *Industrial Relations Act* which came into force in 1994. By 2006, about one-half of all employees in the federal jurisdiction were covered by an enterprise agreement. In 2006, the government enacted legislation known as *WorkChoices*, which introduced significant changes to the workplace relations system to further deregulate labour markets. With the change in government in 2007, this legislation was repealed in 2008.

Those in favour of deregulation argue that it leads to increased employment and economic growth. Deregulation allows employers to be more flexible with the wages paid, which means that wages will rise in areas with strong labour demand, sending a signal to workers to supply more labour to those areas. Deregulation also allows for employers to adjust the quantity of hours worked without having to pay significant rates for overtime hours, which leads to some employers closing their businesses on holidays or Sundays as it is not profitable for them to pay overtime. It has also been argued by some economists that minimum wages reduce employment for unskilled or low-skilled workers. Further, proponents of deregulation argue that workplace disputes are more easily solved at the workplace level.

Those against deregulation argue that while it can lead to higher wages for the skilled workforce, it can lead to lower wages and poorer working conditions for the low-skilled or unskilled. Unskilled labour is highly substitutable, and such workers are therefore not in a position to bargain for improved wages or conditions. This also leads to issues of equity in society. Further, those against full deregulation of the labour market argue that minimum wage legislation is necessary to protect the low-skilled from being paid at rates that are too low to support a reasonable standard of living.

119) B

120) D

121) C

- 122) A
- 123) C
- 124) B
- 125) D
- 126) A
- 127) A
- 128) A
- 129) B
- 130) B
- 131) C
- 132) D
- 133) B
- 134) D
- 135) B
- 136) C
- 137) C
- 138) C
- 139) B
- 140) B
- 141) B
- 142) C
- 143) B
- 144) TRUE
- 145) TRUE
- 146) FALSE
- 147) TRUE

148) The price level is a measure of the average prices of goods and services in the economy. A sustained increase in the general price level of the economy is called inflation. The inflation rate is the percentage increase in the general price level of the economy from one period of time to the next, usually expressed annually.

149) There are 11 broad categories of goods and services in the CPI market basket. Almost half of the market basket comprises housing, transportation and food.

150) Three examples of price indices are the GDP deflator, the consumer price index, and the producer price index. All three differ by the kinds of goods that are contained in the market basket that is used to calculate the average level of prices. The GDP deflator is based on the average price of all final goods and services produced in the economy. The consumer price index is based on the average price of consumer goods and services purchased by households. The producer price index is based on the prices received by producers of goods and services at all stages of the production process.

151) Disease affecting apple trees that significantly reduced the supply of apples would lead to a large price increase of apples. As apples are commonly purchased, they are an important component of the CPI market basket. Therefore, the CPI would rise substantially, indicating an increase in the rate of inflation that year. However, it is unlikely that people would continue to purchase the same quantities of apples if they were very expensive, and would instead substitute other fruit for apples. Therefore the prices of the goods that consumers actually buy would rise by less than the prices in the CPI market basket.

152) Total expenditures for 2005 =  $(10 \times \$1.00) + (15 \times \$5.00) + (8 \times \$2.00) = \$101.00$ .

Total expenditures for 2013 =  $(10 \times \$1.50) + (15 \times \$7.00) + (8 \times \$3.00) = \$144.00$ .

Total expenditures for 2014 =  $(10 \times \$1.75) + (15 \times \$6.75) + (8 \times \$3.50) = \$146.75$ .

The CPI for 2013 =  $[(\$144.00/\$101.00) \times 100] = 142.57$ .

The CPI for 2014 =  $[(\$146.75/\$101.00) \times 100] = 145.30$ .

So, the inflation rate for 2014 =  $[(145.30 - 142.57)/142.57 \times 100] = 1.9$  per cent.

153) The Australian Bureau of Statistics (ABS) surveys a sample of households in the eight capital cities to determine their spending habits and to construct a listing or market basket of these goods. The survey is also used to determine the importance of the items in the consumer's budget. Each month, the ABS collects the prices of the goods in the market



basket from various capital city stores. A weighted average is taken of those prices, with the more important items receiving higher weights. A base year is chosen and the CPI is set to 100 in the base year. In every other year, the CPI is calculated as the ratio of the cost of the market basket in that year, divided by the cost of the market basket in the base year, multiplied by 100.

The CPI does not always produce an entirely accurate measure of prices in the economy. Possible problems include: substitution bias—where people stop buying some goods and services when their prices rise significantly (buying substitutes instead), but the CPI market basket still bases its estimates on the same quantity and types of purchases; increase in quality bias—where price increases may be due to quality increases; new product bias—the CPI market basket is only revised every five years or so, and may therefore contain products that are no longer commonly purchased or may not contain commonly purchased new products; and outlet bias—where people buy goods and services from retailers outside of the capital cities, at discount stores, or via the internet.

154) C

155) A

156) C

157) C

158) A

159) A

160) B

161) D

162) D

163) B

164) TRUE

165) FALSE

166) Real average hourly earnings in 2012 are  $\left[ \frac{\$10}{100} \right] \times 100 = \$10$ .

Real average hourly earnings in 2013 are  $\left[ \frac{\$11}{105} \right] \times 100 = \$10.48$ .

Real average hourly earnings in 2014 are  $\left[ \frac{\$12}{110} \right] \times 100 = \$10.91$ .

The rate of growth of real average hourly earnings from 2013 to 2014 is

$\left[ \frac{\$10.91 - \$10.48}{10.48} \right] \times 100 = 4.103$  per cent.

167) The real average wage in 1993 is  $\left[ \frac{\$2}{49.3} \right] \times 100 = \$4.06$ .

The real average wage in 2013 is  $\left[ \frac{\$6}{190.2} \right] \times 100 = \$3.15$ .

The rate of growth of the real wage from 1993 to 2013 is  $\left[ \frac{\$3.15 - \$4.06}{\$4.06} \right] \times 100 = -22$  per cent.

Workers who earned wages were better off in 1993 as compared to 2013. The value of the average wage was higher in 1993. It has declined by 22 per cent from 1993 to 2013.

168) A

169) B

170) C

171) D

172) D

173) B

174) B

- 175) B
- 176) B
- 177) B
- 178) A
- 179) A
- 180) C
- 181) D
- 182) C
- 183) D
- 184) FALSE
- 185) FALSE
- 186) TRUE
- 187) TRUE
- 188) TRUE
- 189) FALSE
- 190) FALSE
- 191) TRUE

192) No, inflation does not mean that consumers can no longer afford to buy as many goods and services, as nominal incomes generally increase with inflation. Therefore goods and services for the average consumer will be just as affordable. Exceptions to this are people on fixed incomes, or people who are unable to bargain for nominal wage increases sufficient to keep up with inflation.

193) The nominal interest rate includes a charge to compensate the lender for the loss in purchasing power that results from inflation. This is called an 'inflation premium' and is equal to the amount of inflation that the lender expects over the period of a loan. If inflation unexpectedly rises, the lender is not compensated enough for the loss in purchasing power. Likewise, the borrower pays too little to compensate the lender for inflation. So it is better to be a borrower in times of unexpected rising inflation.

When inflation unexpectedly falls, then the lender is compensated too much for inflation as the inflation premium is higher than actual inflation. The borrower likewise pays too much for inflation. So it is better to be a lender than a borrower during a period of unexpected declining inflation.

194) First, there will be redistribution as some people's incomes fall behind even an anticipated level of inflation. Second, firms and individuals must hold money to perform transactions. Those people holding money will lose purchasing power at a rate equal to inflation. Third, firms must pay individuals to change prices. These costs are called 'menu costs,' and can be substantial at very high levels of inflation. Fourth, investors have to pay higher taxes on interest and capital gains income, as the government taxes nominal interest and capital gains income. Investors then lose real after-tax income. This is similar for individuals paying income tax, as income tax brackets are not regularly adjusted for inflation.

195) Hyperinflation refers to extremely rapid increases in the general price level. The rate of inflation can exceed thousands or millions of per cent per year. It does not commonly occur, but there are a number of instances of hyperinflation throughout history, and it has also occurred in recent times.

196) Deflation is a decline in the general level of prices; that is, the rate of inflation is negative. Deflation increases the debt burden of borrowers, as the value of the money that they pay back is greater than the value when they borrowed it. Deflation causes a decrease in the value of assets.

197) Lenders require compensation for inflation when charging interest. The nominal interest rate they charge equals the real rate of interest plus the expected inflation over the loan contract period. The interest rate they charge is determined at the beginning of the loan period, so the charge for inflation is a prediction of what the lender thinks inflation will be over the contract period. If the loan has a fixed rate, the interest rate does not change over the period of the loan. If the lender under-predicts inflation, then the lender will not be compensated enough for the loss in purchasing power due to inflation. The lender will lose to the extent of the under-prediction.

If the loan is a variable-rate loan, the interest rate can be adjusted upwards if the lender under-predicts inflation. This can lower the loss to the lender. The variable rate automatically adjusts for mistakes in predicting inflation. The more frequently the rate can be adjusted, the less the lender's losses will be.

- 198) A
- 199) B

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200) C

201) C

202) A

203) A

204) C

205) C

206) FALSE

207) FALSE

208) Demand-pull inflation is caused by an increase in aggregate demand when production levels are not able to meet this demand. It occurs when the economy is near, at, or beyond full employment. Cost-push inflation is caused by anything that decreases aggregate supply, such as an oil price shock, or an increase in real wages that is greater than the corresponding increase in labour productivity.