Section 1: Measured Unemployment

Based on the reading from Chapter 15 and Lecture 10.

Suppose the following is a complete description of the adult population of the economy:

a. _N_ 10 are retired,
b. _N_ 5 people are in the military,
c. _N_ 5 people are in prison,
d. _N_ 15 people are stay-at-home parents,
e. _E_ 5 are students that work part time,
f. _N_ 5 are students that do not work,
g. _E_ 15 work in 1 part time job,
h. _E_ 5 work in 2 part time jobs,
i. _E_ 20 work full time in 1 job,
j. _E_ 5 work 1 full time job and 1 part time job,
k. _U_ 5 have no job and are applying for jobs,
l. _E_ 5 have a job, and are applying for a second job

a) In the blanks above, write “E” for employed or “U” for unemployed for each group. If they are neither, write “N”.
b) How many are counted as employed? 55
c) How many are counted as unemployed? 5
d) What is the unemployment rate? 8.3%
e) What is the labor force participation rate? 60%
f) How is the unemployment rate affected by each of the following:
   i. Some of the people looking for work give up looking. down
   ii. Some of the full time workers are reduced to part time work. same
   iii. Some of the workers who work 2 jobs lose one of them. same
   iv. Some people who work full time decide to retire. up
Section 2: International Allocation Puzzle

Based on Lectures 7 and 11.

Suppose people in both China and the US have preferences given by a utility function: \( U = ab \), where \( a \) is consumption this year and \( b \) is consumption next year. Suppose China has an income of 480 this year and 1,000 next year, and the US has an income of 2,000 this year and 2,600 next year.

a) Suppose China and the US do not trade, so their consumption in both periods is equal to their income. What are their respective levels of utility?
US: 5,200,000  
China: 480,000

b) Now suppose that they are able to trade. Suppose that China borrows 20 this year and pays back 30 to the US next year. Recompute utility for both countries. Who is better off?
US: 5,207,400  
China: 485,000  
Both are better off

c) Suppose, alternatively, that China lends to the US. Because US interest rates are low, China lends the US 20 this year and gets paid back 25 next year. Recompute utility for both countries.
US: 5,201,500  
China: 471,500

d) What are two explanations of why China has such a high savings rate, even with high growth potential? (see Lecture 7) Age structure, lack of insurance markets, bad financial markets, government policy to encourage trade.

e) What are some risks to the US associated with its high trade deficit? Accumulate a lot of debt, which could cause a financial crisis if there is suddenly an increase in interest rates, or if international investors suddenly perceive the US to be a risky place to invest.
Section 3: Exchange Rates and Net Capital Outflows

Based on Lecture 12 and chapter 19.

In each of the following situations use graphs to demonstrate how interest rates, the quantity of loanable funds, net capital outflows, net exports and exchange rates are affected.

1) There is an increase in the return on investments made in foreign countries.

   Shift right of NCO and demand for loanable funds, increases interest rate, quantity of loanable funds, NCO, and NX, and decreases e.

2) The domestic government increases its budget deficit.

   Shift left of Supply of loanable funds, increases interest rate, decreases loanable funds, decreases NCO and NX, and increases e.

3) There is a reduction in tariffs charged on imports from abroad.

   Shift left of NX, so everything stays the same except that the exchange rate goes down.

4) A new technology makes domestic firms want to invest more.

   Shift right of demand for loanable funds, which increases interest rate and loanable funds, reduces NCO, reduces NX and increases e.
Section 4: “Continental Breakup”

Please listen to the following episode of This American Life:

http://www.thisamericanlife.org/radio-archives/episode/455/continental-breakup

a) At its implementation, what were the goals of the creation of the Euro? 
   Encourage cooperation among European nations and stabilize their economies (especially inflation)

b) What does the phrase “becoming more German” mean in the program? 
   Guard against inflation and borrow responsibly

c) What effect did the introduction of the Euro have on Greek credit markets? 
   Huge drops in Greek interest rates

d) What effect did the Euro have on government spending projects in Greece, Spain and other countries? 
   With the ability to borrow cheaply, many countries used financing to increase spending

e) What event (associated with a change in government) made people worry about the Greek economy? 
   Revision of Greek deficits

f) How did that event affect Greek debt? 
   Investors stopped lending to Greece and interest rates increased

g) How did the crisis affect Greek consumers? 
   Made it difficult to get cheap financing and lead to an economic collapse

h) If Greece was not part of the Euro, what is one way they could respond to the crisis that they cannot do now? 
   Currency devaluation through inflation

i) In your opinion, who is most responsible for the situation in Greece? Why?

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Section 5: Sargent Nobel Prize Lecture

Please watch the following lecture by Tom Sargent:


a) What was the source of the debts that US federal and state governments had incurred at the end of the 18th century? Revolutionary War

b) What are two reasons that governments may have high debts today?
   Started with high debt, or ran deficits in the past

c) What are high government debts today a signal of? Higher future taxes

d) Suppose a government wants to increase the value of its debt. What are two things they can do? Change the “surplus process” or convince people they are less likely to default

e) What were two differences in how the government operated under the Articles of Confederation and under the US Constitution? Under the Articles of Confederation the central government had no ability to raise revenue, and the states each had their own trade/fiscal policy

f) How did the US Constitution resolve the debt crisis? Centralized the power to tax and the ownership of the debt

g) Why did the federal government not bail out state debts in the 1840s?
   So that they wouldn’t establish a precedent of bailing them out

h) What are two similarities and two differences between the US debt crisis of the 1780s and the ongoing European debt crisis?
   Similarities: decentralized taxing power, deep discounts on bond;
   Differences: EU has no central debt and a centralized monetary arrangement
Section 6: Unemployment in your Assigned Country

What country were you assigned to study? ______________________________

Go to the following link:


3) Find the name of your country, then select the “Series” tab, go to the “U” heading and select all series that start with “Unemployment”, then select the “Time” tab and choose all years from 2008 to the latest available. Then press “Table” in the top right.

4) If the table has numbers in it, print and attach the table to your homework and go to part 3. If the table has no numbers, then the World Bank has no information about unemployment for your country. Instead go here:

http://www.tradingeconomics.com/country-list/unemployment-rate

Find your country (may need to use the continent tab below the map), and click on it to get all available information. Do your best to answer question 4 with this or other information you can find. List any other sources you use.

5) How has unemployment in your country’s recent past changed? Is this change due to some recent event in the history of your country? ________________________________

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6) What does the composition of unemployment across different groups tell us about special challenges your country faces? Does the composition suggest any measures that the government could or should take to combat unemployment problems?

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