



- Name: _____
 - Date: _____
 - Section: _____
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BUS 201: Principles of Global Economics

Problem Set #8: Suggested Solutions

Fall 2025

INSTRUCTIONS:

- Write your full name, date, and section clearly at the top of the first page.
- This problem set is designed as a check-in assignment to help you practice the core ideas. It is not intended to be difficult, but you are expected to think carefully about your answers.
- For multiple-choice problems, circle the best answer.
- For short-answer problems, limit your response to no more than 4 sentences. Be concise but complete, and use economic reasoning in your answers.
- You may use your textbook, lecture slides, and personal notes.

Problem 1. Multiple Choice

1.A. The unemployment rate measures:

- a) The percentage of the adult population that is unemployed.
- b) The percentage of the labor force that is unemployed.**
- c) The percentage of marginally attached workers without jobs.
- d) The percentage of discouraged workers without jobs.

1.B. A discouraged worker is someone who:

- a) Is unemployed and actively looking for work.
- b) Is employed part time for economic reasons.
- c) Has stopped looking for work even though they would like a job.**
- d) Is counted as unemployed in official statistics.

1.C. Frictional unemployment exists because:

- a) The business cycle eliminates job opportunities in recessions.
- b) Workers need time to search for jobs that best match their skills and preferences.**
- c) Wages are always set above equilibrium.
- d) Workers refuse to accept any available job offers.

1.D. Structural unemployment can result from:

- a) Temporary changes in job search time.
- b) Workers voluntarily quitting to find better matches.
- c) Wages being held above the market-clearing level.**
- d) Random fluctuations in seasonal employment.

1.E. Which of the following describes cyclical unemployment?

- a) Unemployment caused by workers searching for jobs that better match their skills.
- b) Unemployment that results from wages being set above the equilibrium level.
- c) Unemployment that exists even when the economy is producing at its long-run potential.
- d) Unemployment that rises during economic downturns and falls during expansions.**

Problem 1. Multiple Choice (continued)

1.F. Which of the following is a function of money?

- a) A mechanism for creating new goods.
- b) A method for eliminating inflation.
- c) A store of value.**
- d) A substitute for financial markets.

1.G. Commodity money differs from fiat money because:

- a) Commodity money has intrinsic value, while fiat money does not.**
- b) Fiat money is used only in barter economies.
- c) Commodity money cannot serve as a medium of exchange.
- d) Fiat money cannot serve as a store of value.

1.H. The reserve ratio refers to:

- a) The fraction of deposits banks hold as reserves.**
- b) The fraction of deposits banks loan out.
- c) The interest rate the Fed pays on reserves.
- d) The total value of loans created by the banking system.

1.I. Open-market purchases by the Fed:

- a) Reduce the monetary base.
- b) Decrease the money supply.
- c) Have no effect on interest rates.
- d) Increase bank reserves.**

1.J. The money multiplier becomes smaller when:

- a) Banks choose to hold fewer excess reserves.
- b) The reserve ratio rises.**
- c) The public holds less currency and more deposits.
- d) The Fed conducts open-market purchases.

Problem 2. True / False

Determine whether each statement is TRUE or FALSE. If you deem that the statement is FALSE, you MUST justify your verdict by providing a brief explanation.

2.A. A person who is not working and has not searched for a job within the last four weeks is counted as unemployed.

- FALSE
- A person who has not searched for a job in the last four weeks is not counted as unemployed. They are classified as not in the labor force, even if they would like a job. To be counted as unemployed, a person must be available for work and have actively looked for work within the past four weeks.

2.B. Structural unemployment arises when wages are set above the level that balances supply and demand in the labor market.

- TRUE

2.C. Money serves as a medium of exchange, a unit of account, and a store of value.

- TRUE

2.D. When the Fed conducts an open-market sale of government bonds, the money supply increases.

- FALSE
- An open-market sale of government bonds decreases the money supply, not increases it. When the Fed sells bonds, the public pays the Fed, which reduces bank reserves. Lower reserves reduce banks' ability to make loans, which decreases the money supply.

Problem 3. Short Answer

3.A. Explain why frictional unemployment is unavoidable in a dynamic economy. In your answer, refer to how job matching and information affect the labor market.

- Workers and firms are constantly entering and leaving the labor market, which creates job turnover.
- Workers need time to search for positions that match their skills, preferences, and circumstances, and employers need time to evaluate candidates.
- Information in the labor market is imperfect, so workers cannot instantly find the best available job.
- Because the economy is always changing, some amount of job search and matching is unavoidable.

3.B. Workers who receive unemployment insurance often take longer to find new jobs. Explain why this may occur, and discuss whether this outcome is always undesirable.

- Unemployment insurance reduces the immediate financial pressure to accept the first available job, so recipients may search longer to find a better match.
- This longer search can raise the duration of unemployment, but it may lead to better long-run matches between workers and firms.
- The outcome is not always undesirable because improved job matches can benefit both workers and the broader economy.

Problem 3. Short Answer

3.C. Suppose the reserve ratio in the banking system is 20%. A new deposit of \$5,000 enters the banking system. Using the simple money multiplier, calculate the maximum possible increase in the money supply. Show your reasoning briefly.

- The simple money multiplier equals one divided by the reserve ratio, so the multiplier is 1 divided by 0.20, which equals 5.
- A new deposit of \$5,000 can support up to \$25,000 in total money creation in the banking system.
- The maximum possible increase in the money supply is \$25,000 minus the original deposit, which equals \$20,000. This excludes the original deposit, because only newly created money counts toward the increase in the money supply.
- This represents the most expansion possible under the simple model, which assumes banks hold no excess reserves and all loans are redeposited.

3.D. Discuss one advantage and one limitation of fiat money. Why does fiat money remain valuable even though it lacks intrinsic value?

- Advantage: Fiat money is inexpensive to produce and flexible for monetary policy, which makes it easier for central banks to manage the economy.
- Limitation: Fiat money relies on public trust and can lose value if the monetary authority creates too much of it or loses credibility.
- Fiat money remains valuable because it is accepted as legal tender and people believe others will accept it in exchange for goods and services. Its value is supported by government backing and by the stability of the monetary system.

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