Macroeconomics, Module 20: Public Debt and Social Security

Homework Assignment: Reducing Unemployment

(The attached PDF file has better formatting.)

Unemployment has been rising in a country, leading to voter discontent with current economic policies. The government is considering several proposals to avoid losing votes in the next election. For each of the proposals below, explain the likely effects on the economy.

A. Raise the money supply to stimulate the economy. The higher money supply will reduce the real interest rate. Firms will borrow to finance new projects and hiring will increase.
B. Raise unemployment benefits to help laid off workers. Unemployed workers will be less unhappy, and they are less likely to vote against the government.
C. Create government "make-work jobs" to reduce unemployment.
D. Require firms to give a severance package of six months pay to all permanent workers who are fired. This prevents firms from firing workers needlessly.
E. Raise tariffs to prevent foreign firms from taking U.S. jobs.

For Part A: Will the increase in the money supply affect the real interest rate? What are the likely effects on the economy?

For Part B: How will greater unemployment benefits affect the unemployment rate?

For Part C: Government spending is a component of GDP, so if spending increases, GDP increases. But if the jobs do not create real goods, true GDP does not grow. The higher government spending is financed by higher taxes or by borrowing. How do the higher taxes and borrowing affect GDP?

For Part D: How will this law affect the job finding rate, or the willingness of firms to hire new workers? Will the natural unemployment rate increase or decrease?

For Part E: If prices of imported goods rise, how will consumption, savings, and investment change? If other countries retaliate by raising tariffs as well, how will this change the country's exports? What is the likely effect on GDP and unemployment?

All five of these proposals are commonly used (or have been commonly used) in the United States and Europe. Some economists say that governments often make things worse by economic policies intended to stimulate the economy. Several European countries now realize that government programs to reduce unemployment often make the problem worse, but it is easier to realize the problem than to fix it. France and Great Britain discuss their problems in the press and politicians vow to correct them, but actual reforms are weak.