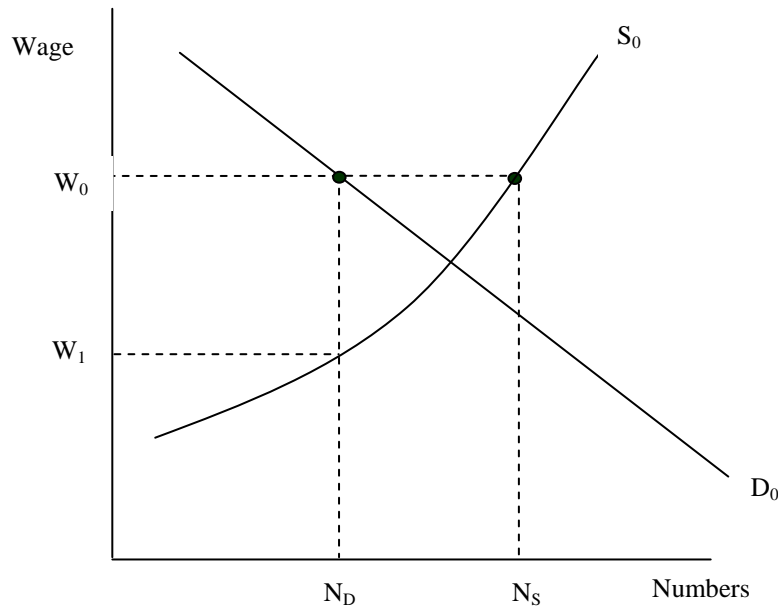


Econ. 320
Problem Set 2

1) The U.S. unemployment rate is lower than that of most European countries (see Table 1 below). Many economists have explained the difference by greater labor market flexibility in the U.S. economy.



The graph above illustrates a labor market that, at a wage of W_0 , has unemployment equal to $N_S - N_D$. In theory, market forces should eliminate unemployment over time. How would the following policies tend to raise the unemployment rate by slowing the path toward equilibrium?

- a) Laws restricting firing employees.
- b) Increasing the duration of unemployment benefits from 6 months to one year.
- c) A negotiated contract that sets the wage at W_0 for 3 years.

2) Suppose $N_S = 120,000$ and $N_D = 100,000$. There are 20,000 people over 16 who are not in the labor force. What is the unemployment rate? What is the employment rate? What is the labor force participation rate?

Table 1: Unemployment rates for various countries

Year	2006
Japan	4.2
Netherlands	4.4
United States	4.6
Australia	4.8
Canada	5.5
United Kingdom	5.5
Italy	6.9
Sweden	7
France	9.7
Germany	10.4

Source: U.S. Bureau of Labor Statistics <http://stats.bls.gov/fls/flscomparelf.htm>