

Quiz 3

Name: **Answer Key**

1. True or false (3 points):

In the short run, only output prices change, whereas in the long run, both output and input prices change.

Your answer: **T**

SR: only price level changes

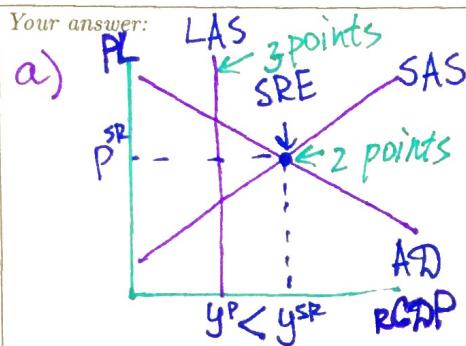
LR: price level + nominal wages change

2. Short answer (17 points):

5 points a) Plot short-run macroeconomic equilibrium for the case where equilibrium real GDP exceeds potential GDP.

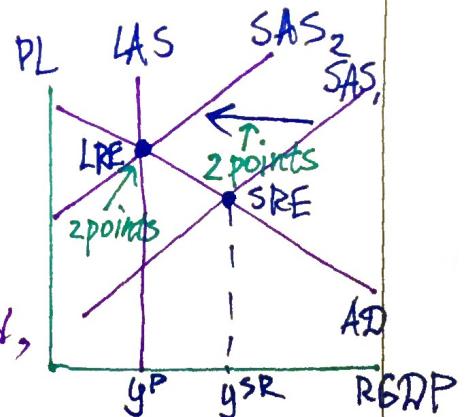
6 points b) Briefly explain how the economy transitions to the long-run macroeconomic equilibrium. Plot the long-run macroeconomic equilibrium. Use arrows to show the transition.

6 points c) Show using plot(s) what happens to the short-run and long-run equilibria if the production technology permanently improves. *Make sure to label all the axes, curves, and equilibria points and use arrows.*

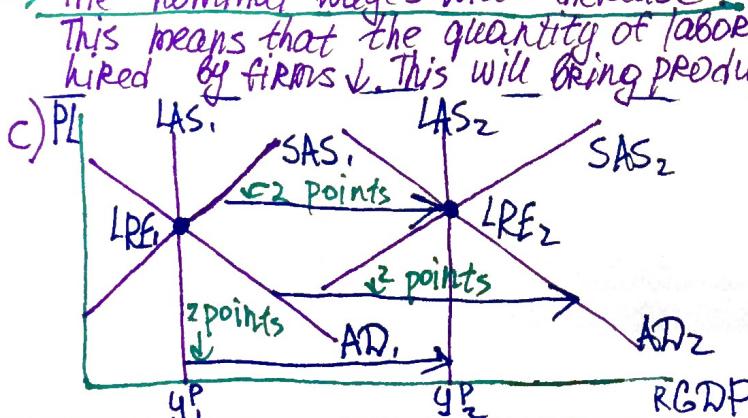


SRE point clearly labeled: 2 points
LAS curve is to the right of SRE: 3 points

b) **SR: W^N is constant**
In the longer run, nominal wages adjust.
In the scenario above since $y_{SR} > y^P$, the economy is overemployed, i.e. there is a surplus of labor.
The nominal wages will increase.



2 points → This means that the quantity of labor hired by firms ↓. This will bring production to y^P level.



A ↑ → $y^P \uparrow$
SR production ↑
WORKERS get higher income ⇒ demand ↑

1 not labeled/mislabeled axis or curve: -0.5 points