Exercise walk-through

Long-Run Self-Adjustment ▪ 3.7

eXercise

You must be able to

- explain how an economy in a **recessionary** or **inflationary gap** returns to full employment on its own
- describe how changes in **nominal wages** shift SRAS during self-adjustment
- compare the long-run outcome (output back at potential) with the short-run effect on the price level

Method — Closing a recessionary gap

High unemployment pushes **nominal wages down**, lowering costs, so SRAS shifts **right** until output returns to potential — at a **lower** price level.

Method — Closing an inflationary gap

Low unemployment pushes **nominal wages up**, raising costs, so SRAS shifts **left** until output returns to potential — at a **higher** price level.

Method — Long-run outcome

Either way, output returns to **potential**; only the price level is permanently changed.

Practice 2.1 ▪ 2 marks

Explain how an economy in a recessionary gap self-corrects.

Solution 2.1

Worked steps

high unemployment lowers nominal wages **B1**, which lowers costs and shifts SRAS right until output is back at potential **B1**.

Practice 2.2 ▪ 1 mark

State what happens to nominal wages during a recessionary gap.

Solution 2.2

Method: Closing a recessionary gap

Worked steps

they fall B1.

Practice 2.3 ▪ 1 mark

State the long-run level of output after self-adjustment.

Solution 2.3

Method: Long-run outcome

Worked steps

potential (full-employment) output **B1**.

Exam-style 3.1 ▪ 1 mark

In a recessionary gap, self-correction happens as nominal wages

A rise

B fall

C stay fixed

D disappear

Solution 3.1

Method: Closing a recessionary gap

A rise

B fall ✓

C stay fixed

D disappear

Worked steps

B.

Exam-style 3.2 ▪ 1 mark

After long-run self-adjustment, output returns to

- **A** zero
- **B** potential output
- **C** above potential
- **D** below potential

Solution 3.2

Method: Long-run outcome

A zero

B potential output ✓

C above potential

D below potential

Worked steps

B.

Exam-style 3.3 ▪ 1 mark

An economy has an inflationary gap.

(a) State what happens to nominal wages over time.

(b) State the direction SRAS shifts.

(c) State the long-run level of output.

Solution 3.3

Method: Closing an inflationary gap

Worked steps

(a) they rise **B1**. (b) to the left **B1**. (c) potential output **B1**.