

Chapter 23: Short Answer

- 1) Why does income = expenditure = GDP?
- 2) Define GDP and explain the important terms in the definition.
- 3) What are the components of expenditure? Provide an example of each.
- 4) Provide an example of a transfer payment. Do we include it in GDP? Why?
- 5) If nominal GDP in 2005 exceeds nominal GDP in 2004, did real output rise? Did prices rise?
- 6) If real GDP in 2005 exceeds real GDP in 2004, did real output rise? Did prices rise?
- 7) If you buy a \$20,000 Toyota that was produced entirely in Japan, does affect US GDP? Show how this transaction would affect the appropriate expenditure categories that make up GDP.
- 8) Explain the difference between GDP and GNP. If the residents of the United States generate as much production in the rest of the world produces in the United States, what would be true about US GDP and GNP?
- 9) Which contributes more when measuring GDP, a new diamond necklace purchased by a wealthy person or a soda purchased by a thirsty person? Why?
- 10) If your neighbor hires you to mow her lawn instead of doing it herself, what will happen to GDP? Why? Did output change?

Chapter 23: Advanced Critical Thinking

You are watching a news report with your father. The news anchor points out that a certain troubled Caribbean nation generates a GDP per capita of only \$350 per year. Since your father knows that the US GDP per capita is approximately \$35,000, he suggests that we are materially 100 times better off in the United States than in the Caribbean nation/

- 1) Is your father's statement accurate?
- 2) What general category of production is not captured by GDP in both the United States and the Caribbean nation?
- 3) Provide some examples of this type of activity.
- 4) Why would the exclusion of this type of production affect the measurement of Caribbean output more than US output?
- 5) Does this mean that residents of the Caribbean nation are actually as well off materially as residents in the United States?

Chapter 24: Short Answer

- 1) What does the consumer price index attempt to measure?
- 2) What are the steps that one must go through in order to construct a consumer price index?
- 3) Which would have a greater impact on the CPI: a 20% increase in the price of Rolex watches or a 20% increase in the price of new cars? Why?
- 4) Suppose there is an increase in the price of imported BMW automobiles (which are produced in Germany). Would this have a larger impact on the CPI or the GDP deflator? Why?
- 5) If the Bureau of Labor Statistics failed to recognize the increase in memory, power, and speed of newer model computers, in which direction would the CPI be biased? What do we call this type of bias?
- 6) What does the real interest rate measure?
- 7) Suppose you lend money to your sister at a nominal interest rate of 10% because you both expect the inflation rate to be 6%. Further, suppose that after the loan has been repaid, you discover that the actual inflation rate over the life of the loan was only 2%. Who gained at the other's expense – you or your sister? Why?
- 8) Paying close attention to question 7, make a general statement with regard to who gains or loses (the borrower or the lender) on a loan contract when inflation turns out to be either higher or lower than expected.
- 9) If workers and firms negotiate a wage increase based on their expectations of inflation, who gains or loses (the workers or the firms) if actual inflation turns out to be higher than expected? Why?

Chapter 24: Advanced Critical Thinking

Your father quit smoking cigarettes in 1965. When you ask him why he quit, you get a surprising answer. Instead of reciting the health benefits of quitting smoking, he says, "I quit because it was getting too expensive. I started smoking in 1965 in Vietnam and cigarettes were only 45 cents a pack. The last pack I bought was \$2.00 and I just couldn't justify spending more than four times as much on cigarettes as I used to."

- 1) In 1965, the CPI was 31.5. In 1995 the CPI was 152.4. While it is commendable that your father quit smoking, what is wrong with his explanation?
- 2) What is the equivalent cost of a 1965 pack of cigarettes measured in 1995 prices?
- 3) What is the equivalent cost of a 1995 pack of cigarettes measured in 1965 prices?
- 4) Do both methods give you the same conclusion?
- 5) The preceding example demonstrates what economists refer to as "money illusion." Why do you think economists might choose the phrase "money illusion" to describe this behavior?

Chapter 28: Short-Answer

- 1) Name two reasons why the unemployment rate is an imperfect measure of joblessness.
- 2) Explain the statement, "Most spells of unemployment are short, and most unemployment observed at any given time is long term."
- 3) Where would a labor union be more likely to increase efficiency rather than reduce it: a small remote town with one large employer or a major city with many employers? Why?
- 4) Name two ways that a union increases the disparity in wages between members and nonmembers.
- 5) Which alternative measure of unemployment attempts to include the impact of discouraged workers in the unemployment statistics? Explain. Is it higher or lower than the official unemployment rate? Explain.
- 6) Does the minimum wage cause much unemployment in the market for accountants? Why?
- 7) Which type of unemployment will occur even if the wage is at the competitive equilibrium? Why?
- 8) How does unemployment insurance increase frictional unemployment?
- 9) How might the government help reduce frictional unemployment?
- 10) Which of the following individuals is most likely to be unemployed for the long term: a buggy whip maker who loses his job when automobiles become popular or a waitress who is laid off when a new café opens in town? Why?

Chapter 28: Advanced Critical Thinking

You are watching the national news with your roommate. The news anchor says, "Unemployment statistics released by the Department of Labor today show an increase in unemployment from 6.1% to 6.2%. This is the third month in a row where the unemployment rate has increased." Your roommate says, "Every month there are fewer and fewer people with jobs. I don't know how much longer the country can continue like this."

- 1) Can your roommate's statement be deduced from the unemployment rate statistic? Why?
- 2) What information would you need to determine whether there are really fewer people with jobs?