

Chapter 23

Economics, Macroeconomics



Chapter 23 Measuring a Nation's Income TRUE/FALSE 1. In years of economic contraction, firms throughout the economy increase their production of goods and services, employment rises, and jobs are easy to find. ANS: F DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Economic expansion MSC: Definitional 2. Macroeconomic statistics include GDP, the inflation rate, the unemployment rate, retail sales, and the trade deficit. ANS: T DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Definitional 3. Macroeconomic statistics tell us about a particular household, firm, or market. ANS: F DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Definitional 4. Macroeconomics is the study of the economy as a whole. ANS: T DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Definitional 5. The goal of macroeconomics is to explain the economic changes that affect many households, firms, and markets simultaneously. ANS: T DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Definitional 6. Microeconomics and macroeconomics are closely linked. ANS: T DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Microeconomics | Macroeconomics MSC: Definitional 7. The basic tools of supply and demand are as central to macroeconomic analysis as they are to microeconomic analysis. ANS: T DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Demand | Supply MSC: Definitional 8. GDP is the most closely watched economic statistic because it is thought to be

the best single measure of a society's economic well-being. ANS: T DIF: 1
REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of
economics TOP: GDP MSC: Definitional 9. GDP can measure either the total
income of everyone in the economy or the total expenditure on the
economy's output of goods and services, but GDP cannot measure both at
the same time. ANS: F DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of
economics and definitions of economics TOP: GDP MSC: Interpretive 10. For
an economy as a whole, income must exceed expenditure. ANS: F DIF: 1
REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of
economics TOP: Income | Expenditure MSC: Definitional 11. An economy's
income is the same as its expenditure because every transaction has a buyer
and a seller. ANS: T DIF: 1 REF: 23-1 NAT: Analytic LOC: The study of
economics and definitions of economics TOP: Income | Expenditure MSC:
Definitional 12. GDP is the market value of all final goods and services
produced by a country's citizens in a given period of time. ANS: F DIF: 1 REF:
23-2 NAT: Analytic LOC: The study of economics and definitions of economics
TOP: GDP MSC: Definitional 13. GDP adds together many different kinds of
products into a single measure of the value of economic activity by using
market prices. ANS: T DIF: 1 REF: 23-2 NAT: Analytic LOC: The study of
economics and definitions of economics TOP: GDP MSC: Definitional 14. U. S.
GDP includes the market value of rental housing, but not the market value of
owner-occupied housing. ANS: F DIF: 2 REF: 23-2 NAT: Analytic LOC: The
study of economics and definitions of economics TOP: GDP MSC: Interpretive
15. U. S. GDP excludes the production of most illegal goods. ANS: T DIF: 2
REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of

economics TOP: GDP MSC: Interpretive 16. U. S. GDP includes estimates of the value of items that are produced and consumed at home, such as housework and car maintenance. ANS: F DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 17. GDP includes only the value of final goods because the value of intermediate goods is already included in the prices of the final goods. ANS: T DIF: 1 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Intermediate goods MSC: Definitional 18. Additions to inventory subtract from GDP, and when the goods in inventory are later used or sold, the reductions in inventory add to GDP. ANS: F DIF: 1 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Inventory MSC: Definitional 19. While GDP includes tangible goods such as books and bug spray, it excludes intangible services such as the services provided by teachers and exterminators. ANS: F DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 20. At a rummage sale, you buy two old books and an old rocking chair; your spending on these items is not included in current GDP. ANS: T DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 21. When an American doctor opens a practice in Bermuda, his production there is part of U. S. GDP. ANS: F DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 22. If the U. S. government reports that GDP in the third quarter was \$12 trillion at an annual rate, then the amount of income and expenditure during quarter three was \$3 trillion. ANS: T DIF: 2 REF: 23-2 NAT: Analytic LOC: The

study of economics and definitions of economics TOP: GDP MSC: Applicative

23. The government computes measures of income other than GDP because these other measures usually tell different stories about overall economic conditions. ANS: F DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Income MSC: Interpretive

24. Expenditures by households on education are included in the consumption component of GDP. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Consumption MSC: Interpretive

25. Most goods whose purchases are included in the investment component of GDP are used to produce other goods. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Investment MSC: Interpretive

26. New home construction is included in the consumption component of GDP. ANS: F DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Investment MSC: Interpretive

27. Changes in inventory are included in the investment component of GDP. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Investment MSC: Interpretive

28. The investment component of GDP refers to financial investment in stocks and bonds. ANS: F DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Investment MSC: Interpretive

29. The government purchases component of GDP includes salaries paid to soldiers but not Social Security benefits paid to the elderly. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Government purchases MSC: Interpretive

30. If the value of an economy's imports exceeds the value of that economy's

exports, then net exports is a negative number. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Net exports MSC: Interpretive 31. If someone in the United States buys a surfboard produced in Australia, then that purchase is included in both the consumption component of U. S. GDP and the net exports component of U. S. GDP. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Consumption | Net exports MSC: Applicative 32. If consumption is \$4000, exports are \$300, government purchases are \$1000, imports are \$400, and investment is \$800, then GDP is \$5700. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 33. If exports are \$500, GDP is \$8000, government purchases are \$1200, imports are \$700, and investment is \$800, then consumption is \$6200. ANS: T DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Consumption MSC: Applicative 34. If consumption is \$1800, GDP is \$4300, government purchases are \$1000, imports are \$700, and investment is \$1200, then exports are \$300. ANS: F DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Exports MSC: Applicative 35. U. S. GDP was almost \$14 billion in 2007. ANS: F DIF: 1 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Definitional 36. In 2007, government purchases was the largest component of U. S. GDP. ANS: F DIF: 2 REF: 23-3 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 37. If total spending rises from one year to the next, then the economy must be producing a larger output of goods and services. ANS: F DIF: 2 REF: 23-4

NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 38. An increase in nominal U. S. GDP necessarily implies that the United States is producing a larger output of goods and services. ANS: F DIF: 2 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Nominal GDP MSC: Interpretive 39. Nominal GDP uses constant base-year prices to place a value on the economy's production of goods and services, while real GDP uses current prices to place a value on the economy's production of goods and services. ANS: F DIF: 1 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Nominal GDP | Real GDP MSC: Definitional 40. Real GDP evaluates current production using prices that are fixed at past levels and therefore shows how the economy's overall production of goods and services changes over time. ANS: T DIF: 1 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP MSC: Definitional 41. The term real GDP refers to a country's actual GDP as opposed to its estimated GDP. ANS: F DIF: 2 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP MSC: Interpretive 42. Changes in real GDP reflect only changes in the amounts being produced. ANS: T DIF: 1 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP MSC: Definitional 43. Real GDP is a better gauge of economic well-being than is nominal GDP. ANS: T DIF: 1 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Nominal GDP | Real GDP MSC: Definitional 44. Changes in the GDP deflator reflect only changes in the prices of goods and services. ANS: T DIF: 2 REF: 23-4 NAT: Analytic LOC: The study of economics

and definitions of economics TOP: GDP deflator MSC: Interpretive 45. If nominal GDP is \$10,000 and real GDP is \$8,000, then the GDP deflator is 125. ANS: T DIF: 2 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP deflator MSC: Applicative 46. If nominal GDP is \$12,000 and the GDP deflator is 80, then real GDP is \$15,000. ANS: T DIF: 2 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP MSC: Applicative 47. Economists use the term inflation to describe a situation in which the economy's overall production level is rising. ANS: F DIF: 1 REF: 23-4 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation MSC: Definitional 48. If the GDP deflator in 2006 was 160 and the GDP deflator in 2007 was 180, then the inflation rate in 2007 was 12.5%. ANS: T DIF: 2 REF: 23-4 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation rate MSC: Applicative 49. If the GDP deflator in 2004 was 150 and the GDP deflator in 2005 was 120, then the inflation rate in 2005 was 25%. ANS: F DIF: 2 REF: 23-4 NAT: Analytic LOC: Unemployment and inflation TOP: Inflation rate MSC: Applicative 50. The GDP deflator can be used to take inflation out of nominal GDP. ANS: T DIF: 1 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP deflator MSC: Definitional 51. In 2004, the level of U. S. real GDP was close to four times its 1965 level. ANS: T DIF: 1 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP MSC: Definitional 52. The output of goods and services produced in the United States has grown on average 3.2 percent per year. ANS: T DIF: 1 REF: 23-4 NAT: Analytic LOC: Productivity and growth TOP: Growth MSC: Definitional 53. Periods during which real GDP rises are called recessions. ANS: F DIF: 1

REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Recessions MSC: Definitional 54. Recessions are associated with lower incomes, rising unemployment, and falling profits. ANS: T DIF: 1

REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Recessions MSC: Definitional 55. If real GDP is higher in one country than in another, then we can be sure that the standard of living is higher in the country with the higher real GDP. ANS: F DIF: 2 REF: 23-5 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP | Standard of living MSC: Interpretive 56. Real GDP per person tells us the income and expenditure of the average person in the economy. ANS: T DIF: 1 REF: 23-5 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP per person MSC: Definitional 57. GDP does not directly measure those things that make life worthwhile, but it does measure our ability to obtain many of the inputs into a worthwhile life. ANS: T DIF: 1 REF: 23-5 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Definitional 58. GDP does not make adjustments for leisure time, environmental quality, or volunteer work. ANS: T DIF: 2 REF: 23-5 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 59. Other things equal, in countries with higher levels of real GDP per person, life expectancy and literacy rates are higher than in countries with lower levels of real GDP per person. ANS: T DIF: 2 REF: 23-5 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive SHORT ANSWER 1. GDP is defined as the market value of all final goods and services produced within a country in a given period of time. In spite of this definition, some production is left out of GDP.

Explain why some final goods and services are not included. ANS: GDP excludes some products because they are so difficult to measure. These products include services performed by individuals for themselves and their families, and most goods that are produced and consumed at home and, therefore, never enter the marketplace. In addition, illegal products are not included in GDP even if they can be measured because, by society's definition, they are bads, not goods. DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive

2. Explain why it is the case that the value of intermediate goods produced and sold during the year is not included directly as part of GDP, but the value of intermediate goods produced and not sold is included directly as part of GDP. ANS: Intermediate goods produced and sold during the year are not included separately as part of GDP because the value of those goods is included in the value of the final goods produced from them. If the intermediate good is produced but not sold during the year, its value is included as inventory investment for the year in which it was produced. If inventory investment was not included as part of GDP, true production would be underestimated for the year the intermediate good went into inventory, and overestimated for the year the intermediate good is used or sold. DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Intermediate goods MSC: Interpretive

3. Since it is counted as investment, why doesn't the purchase of earthmoving equipment from China by a U. S. corporation increase U. S. GDP? ANS: The purchase of foreign equipment is counted as investment, but GDP measures only the value of production within the geographic borders of the United States. In

order to avoid including the value of the imported equipment, imports are subtracted from GDP. Hence, the value of the equipment in investment is canceled by subtracting its value as an import. DIF: 2 REF: 23-3 NAT:

Analytic LOC: The study of economics and definitions of economics TOP: GDP

| Investment | Imports MSC: Applicative 4. Identify the immediate effect of each of the following events on U. S. GDP and its components. | a. | James receives a Social Security check. | | b. | John buys an Italian sports car. | | c. | Henry buys domestically produced tools for his construction company. | ANS:

| a. | Since this is a transfer payment, there is no change to GDP or to any of its components. | | b. | Consumption and imports will rise and cancel each other out so that there is no change in U. S. GDP. | | c. | This increases the investment component of GDP and so increases GDP. | DIF: 2 REF: 23-3 NAT:

Analytic LOC: The study of economics and definitions of economics TOP: GDP

| Transfer payments | Net exports | Investment MSC: Applicative 5. Between 1929 and 1933, NNP measured in current prices fell from \$96 billion to \$48 billion. Over the same period, the relevant price index fell from 100 to 75. | a. | What was the percentage decline in nominal NNP from 1929 to 1933? | | b. | What was the percentage decline in real NNP from 1929 to 1933? Show your work. | ANS: | a. | NNP measured in current prices is nominal NNP.

Nominal NNP fell from \$96 billion to \$48 billion, a decline of 50 percent. | | b.

| Real NNP is nominal NNP divided by the price index and multiplied by 100.

Real NNP in 1929 was $(\$96 \text{ b}/100) [pic] 100 = \96 | | b. Real NNP in 1933 was $(\$48 \text{ b}/75) [pic] 100 = \64 b . Real NNP fell from \$96 billion to \$64

billion, a decline of 33 | | percent. | DIF: 2 REF: 23-4 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Nominal NNP | Real

NNP MSC: Applicative 6. You find that your paycheck for the year is higher this year than last. Does that mean that your real income has increased? Explain carefully. ANS: Real income is nominal income adjusted for general increase in prices. If my paycheck is higher this year than last, my nominal income has increased. Whether my real income has increased or not depends on what has happened since last year to the level of prices of things I buy with my income. If the percentage increase in prices is less than the percentage increase in my nominal income, then my real income has increased. Otherwise, my real income has not increased. DIF: 2 REF: 23-4

NAT: Analytic LOC: The study of economics and definitions of economics TOP: Nominal income | Real income MSC: Interpretive 7. U. S. real GDP is substantially higher today than it was 60 years ago. What does this tell us, and what does it not tell us, about the well-being of U. S. residents? ANS: Since this is in real terms, it tells us that the U. S. is able to make a lot more stuff than in the past. Some of the increase in real GDP is probably due to an increase in population, so we could say more if we knew what had happened to real GDP per person. Supposing that there was also an increase in real GDP per person, we can say that the standard of living has risen. Material things are an important part of well-being. Having sufficient amounts of things such as food, shelter, and clothing are fundamental to well-being. Other things such as security, a safe environment, access to safe water, access to medical care, justice, and freedom also matter. However, many of these things are more easily obtained by being able to produce more using fewer resources. Countries with higher real GDP per person tend to have longer life spans, less discrimination towards women, less child labor, and a

higher rate of literacy. DIF: 2 REF: 23-5 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Real GDP | Economic welfare MSC: Interpretive Sec00 - Measuring a Nation's Income MULTIPLE CHOICE 1. Statistics that are of particular interest to macroeconomists | a. | are largely ignored by the media. | | b. | are widely reported by the media. | | c. | include the equilibrium prices of individual goods and services. | | d. | tell us about a particular household, firm, or market. | ANS: B DIF: 2 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Interpretive 2. Macroeconomists study | a. | the decisions of households and firms. | | b. | the interaction between households and firms. | | c. | economy-wide phenomena. | | d. | regulations on firms and unions. | ANS: C DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Definitional 3. Which of the following newspaper headlines is more closely related to what microeconomists study than to what macroeconomists study? | a. | Unemployment rate rises from 5 percent to 5.5 percent. | | b. | Real GDP grows by 3.1 percent in the third quarter. | | c. | Retail sales at stores show large gains. | | d. | The price of oranges rises after an early frost. | ANS: D DIF: 2 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Microeconomics | Macroeconomics MSC: Interpretive 4. Which of the following questions is more likely to be studied by a microeconomist than a macroeconomist? | a. | Why do prices in general rise by more in some countries than in others? | | b. | Why do wages differ across industries? | | c. | Why do production and income increase in some periods and not in others? | | d. | How rapidly is GDP currently increasing? | ANS: B

DIF: 2 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Microeconomics | Macroeconomics MSC: Interpretive 5.

Which of the following topics are more likely to be studied by a macroeconomist than by a microeconomist? | a. | the effect of taxes on the prices of airline tickets, the profitability of automobile-manufacturing firms, and | | employment trends in the food-service industry | | b. | the price of beef, wage differences between genders, and antitrust laws | | c. | how consumers maximize utility, and how prices are established in markets for agricultural products | | d. | the percentage of the labor force that is out of work, and differences in average income from country to country | ANS: D

DIF: 2 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Microeconomics | Macroeconomics MSC: Interpretive 6.

We would expect a macroeconomist, as opposed to a microeconomist, to be particularly interested in | a. | explaining how economic changes affect prices of particular goods. | | b. | devising policies to deal with market failures such as externalities and market power. | | c. | devising policies to promote low inflation. | | d. | identifying those markets that are competitive and those that are not competitive. | ANS: C DIF: 2 REF: 23-0 NAT: Analytic LOC: The study

of economics and definitions of economics TOP: Microeconomics |

Macroeconomics MSC: Interpretive 7. Which of the following is not a question that macroeconomists address? | a. | Why is average income high in some countries while it is low in others? | | b. | Why does the price of oil rise when war erupts in the Middle East? | | c. | Why do production and employment expand in some years and contract in others? | | d. | Why do prices rise rapidly in some periods of time while they are more stable in other periods? |

ANS: B DIF: 2 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Macroeconomics MSC: Interpretive 8. The basic tools of supply and demand are | a. | useful only in the analysis of economic behavior in individual markets. | | b. | useful in analyzing the overall economy, but not in analyzing individual markets. | | c. | central to microeconomic analysis, but seldom used in macroeconomic analysis. | | d. | central to macroeconomic analysis as well as to microeconomic analysis. |

ANS: D DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Demand | Supply MSC: Definitional 9. Which of the following statistic is usually regarded as the best single measure of a society's economic well-being? | a. | the unemployment rate | | b. | the inflation rate | | c. | gross domestic product | | d. | the trade deficit | ANS: C

DIF: 1 REF: 23-0 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Definitional Sec01 - Measuring a Nation's Income - The Economy's Income and Expenditure MULTIPLE CHOICE 1. Which of the following statements about GDP is correct? | a. | GDP measures two things at once: the total income of everyone in the economy and the unemployment rate of the economy's | | labor force. | | b. | Money continuously flows from households to government and then back to households, and GDP measures this flow of money. | | c. | GDP is to a nation's economy as household income is to a household. | | d. | All of the above are correct. |

ANS: C DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 2. Gross domestic product measures two things at once: | a. | the total spending of everyone in the economy and the total saving of everyone in the economy. | | b. | the

total income of everyone in the economy and the total expenditure on the economy's output of goods and services. | | c. | the value of the economy's output of goods and services for domestic citizens and the value of the economy's output of | | | goods and services for the rest of the world. | | d. | the total income of households in the economy and the total profit of firms in the economy. | ANS: B DIF: 1 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Definitional 3. For an economy as a whole, | a. | wages must equal profit. | | b. | consumption must equal saving. | | c. | income must equal expenditure. | | d. | the number of buyers must equal the number of sellers. | ANS: C DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Income | Expenditure MSC: Interpretive 4. For an economy as a whole, income must equal expenditure because | a. | the number of firms is equal to the number of households in an economy. | | b. | international law requires that income equal expenditure. | | c. | every dollar of spending by some buyer is a dollar of income for some seller. | | d. | every dollar of saving by some consumer is a dollar of spending by some other consumer. | ANS: C DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Income | Expenditure MSC: Interpretive 5. If an economy's GDP rises, then it must be the case that the economy's | a. | income rises and saving falls. | | b. | income and saving both rise. | | c. | income rises and expenditure falls. | | d. | income and expenditure both rise. | ANS: D DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Income | Expenditure MSC: Interpretive 6. If an economy's GDP falls, then it must be the case that the economy's | a. | income falls and

saving rises. | | b. | income and saving both fall. | | c. | income falls and expenditure rises. | | d. | income and expenditure both fall. | ANS: D DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Income | Expenditure MSC: Interpretive 7. Because every transaction has a buyer and a seller, | a. | GDP is more closely associated with an economy's income than it is with an economy's expenditure. | | b. | every transaction contributes equally to an economy's income and to its expenditure. | | c. | the number of firms must be equal to the number of households in a simple circular-flow diagram. | | d. | firms' profits are necessarily zero in a simple circular-flow diagram. | ANS: B DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Income | Expenditure MSC: Interpretive 8. Which of the following statements about GDP is correct? | a. | GDP measures two things at once: the total income of everyone in the economy and the total expenditure on the economy's | | | output of goods and services. | | b. | Money continuously flows from households to firms and then back to households, and GDP measures this flow of money. | | c. | GDP is generally regarded as the best single measure of a society's economic well-being. | | d. | All of the above are correct. | ANS: D DIF: 2 REF: 23-1 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 9. In a simple circular-flow diagram, total income and total expenditure are | a. | never equal because total income always exceeds total expenditure. | | b. | seldom equal because of the ongoing changes in an economy's unemployment rate. | | c. | equal only when one dollar is spent on goods for every dollar that is spent on services. | | d. | always equal because every transaction has a

buyer and a seller. | ANS: D DIF: 2 REF: 23-1 NAT: Analytic LOC:

Understanding and applying economic models TOP: Circular-flow diagram

MSC: Interpretive 10. In a simple circular-flow diagram, | a. | households

spend all of their income. | | b. | all goods and services are bought by

households. | | c. | expenditures flow through the markets for goods and

services, while income flows through the markets for the factors of | | |

production. | | d. | All of the above are correct. | ANS: D DIF: 2 REF: 23-1 NAT:

Analytic LOC: Understanding and applying economic models TOP: Circular-

flow diagram MSC: Interpretive 11. In a simple circular-flow diagram, firms

use the money they get from a sale to | a. | pay wages to workers. | | b. | pay

rent to landlords. | | c. | pay profit to the firms' owners. | | d. | All of the

above are correct. | ANS: D DIF: 1 REF: 23-1 NAT: Analytic LOC:

Understanding and applying economic models TOP: Circular-flow diagram

MSC: Definitional 12. In the actual economy, households | a. | spend all of
their income. | | b. | divide their income among spending, taxes, and saving.

| | c. | buy all goods and services produced in the economy. | | d. | Both (a)

and (c) are correct. | ANS: B DIF: 2 REF: 23-1 NAT: Analytic LOC:

Understanding and applying economic models TOP: Circular-flow diagram

MSC: Interpretive 13. In the actual economy, goods and services are

purchased by | a. | households, but not firms or the government. | | b. |

households and firms, but not the government. | | c. | households and the

government, but not firms. | | d. | households, firms, and the government. |

ANS: D DIF: 2 REF: 23-1 NAT: Analytic LOC: Understanding and applying

economic models TOP: Circular-flow diagram MSC: Interpretive Sec02 -

Measuring a Nation's Income - The Measurement of Gross Domestic Product

MULTIPLE CHOICE 1. GDP is defined as | a. | the market value of all goods and services produced within a country in a given period of time. | | b. | the market value of all goods and services produced by the citizens of a country, regardless of where they are living, | | | in a given period of time. | | c. | the market value of all final goods and services produced within a country in a given period of time. | | d. | the market value of all final goods and services produced by the citizens of a country, regardless of where they are | | | living, in a given period of time. | ANS: C DIF: 1 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC:

Definitional 2. Gross domestic product is defined as | a. | the quantity of all final goods and services demanded within a country in a given period of time. | | b. | the quantity of all final goods and services supplied within a country in a given period of time. | | c. | the market value of all final goods and services produced within a country in a given period of time. | | d. | Both (a) and (b) are correct. | ANS: C DIF: 1 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Definitional

3. To compute GDP, we | a. | add up the wages paid to all workers. | | b. | add up the costs of producing all final goods and services. | | c. | add up the market values of all final goods and services. | | d. | take the difference between the market values of all final goods and services and the costs of producing those final | | | goods and services. | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 4. GDP adds together many different kinds of products into a single measure of the value of economic activity by using prices determined by | a. | banks. | | b. | economists. | | c. | the government. | | d. |

markets. | ANS: D DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 5. In order to include many different goods and services in an aggregate measure, GDP is computed using, primarily, | a. | values of goods and services based on surveys of consumers. | | b. | market prices. | | c. | consumer and producer surpluses. | | d. | costs of producing goods and services. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 6. Gross domestic product adds together many different kinds of goods and services into a single measure of the value of economic activity. To do this, GDP makes use of | a. | market prices. | | b. | prices that government economists believe reflect the true value of goods and services to society. | | c. | the assumption that quantities of goods and services produced are unchanged from year to year. | | d. | the assumption that prices of goods and services are unchanged from year to year. | ANS: A DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 7. In computing GDP, market prices are used to value final goods and services because | a. | market prices do not change much over time, so it is easy to make comparisons between years. | | b. | market prices reflect the values of goods and services. | | c. | if market prices are out of line with how people value goods, the government sets price ceilings and price floors. | | d. | None of the above is correct; market prices are not used in computing GDP. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 8. If the price of a DVD player is three times the price of a CD player, then a DVD player contributes | a. | more than

three times as much to GDP as does a CD player. | | b. | less than three times as much to GDP as does a CD player. | | c. | exactly three times as much to GDP as does a CD player. | | d. | to GDP but a CD player does not contribute to GDP. | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 9. Which of the following is correct? | a. | The market value of rental housing services is included in GDP, but the market value of owner-occupied housing services | | | is not. | | b. | The market value of owner-occupied housing services is included in GDP, but the market value of rental housing services | | | is not. | | c. | The market values of both owner-occupied housing services and rental housing services are included in GDP. | | d. | Neither the market value of owner-occupied housing services nor the market value of rental housing services is included | | | in GDP. | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 10. The value of the housing services provided by the economy's owner-occupied houses is | a. | included in GDP, and the estimated rental values of the houses are used to place a value on these housing services. | | b. | included in GDP, and the actual mortgage payments made on the houses are used to estimate the value of these rental | | | services. | | c. | excluded from GDP since these services are not sold in any market. | | d. | excluded from GDP since the value of these housing services cannot be estimated with any degree of precision. | ANS: A DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive 11. Suppose an apartment complex converts to a condominium, so that the former renters are now owners of their housing units. Suppose further that a

current estimate of the value of the condominium owners' housing services is the same as the rent they previously paid. What happens to GDP as a result of this conversion? | a. | GDP necessarily increases. | | b. | GDP necessarily decreases. | | c. | GDP is unaffected because neither the rent nor the estimate of the value of housing services is included in GDP. | | d. | GDP is unaffected because previously the rent payments were included in GDP and now the rent payments are replaced in | | | GDP by the estimate of the value of housing services. | ANS: D DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative

12. James owns two houses. He rents one house to the Johnson family for \$10, 000 per year. He lives in the other house. If he were to rent the house in which he lives, he could earn \$12, 000 per year in rent by doing so. How much do the housing services provided by the two houses contribute to GDP? | a. |\$0 | | b. |\$10, 000 | | c. |\$12, 000 | | d. |\$22, 000 | ANS: D DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative

13. GDP excludes most items that are produced and sold illegally and most items that are produced and consumed at home because | a. | the quality of these items is not high enough to contribute value to GDP. | | b. | measuring them is so difficult. | | c. | the government wants to discourage the production and consumption of these items. | | d. | these items are not reported on income tax forms. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Interpretive

14. Estimates of the values of which of the following non-market goods or services are included in GDP? | a. | the value of unpaid housework | | b. | the value of vegetables and other foods

that people grow in their gardens | | c. | the estimated rental value of owner-occupied homes | | d. | All of the above are included in GDP. | ANS: C DIF: 2

REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 15. Over the last few decades,

Americans have chosen to cook less at home and eat more at restaurants.

This change in behavior, by itself, has | a. | reduced measured GDP. | | b. |

not affected measured GDP. | | c. | increased measured GDP only to the

extent that the value of the restaurant meals exceeded the value of meals previously | | | cooked at home. | | d. | increased measured GDP by the full

value of the restaurant meals. | ANS: D DIF: 2 REF: 23-2 NAT: Analytic LOC:

The study of economics and definitions of economics TOP: GDP MSC:

Applicative 16. Over time, people have come to rely more on market-

produced goods and less on goods that they produce for themselves. For

example, busy people with high incomes, rather than cleaning their own houses, hire people to clean their houses. By itself, this change has | a. |

caused measured GDP to fall. | | b. | not caused any change in measured

GDP. | | c. | caused measured GDP to rise. | | d. | probably changed

measured GDP, but in an uncertain direction; the direction of the change

depends on the difference in | | | the quality of the cleaning that has

resulted. | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of

economics and definitions of economics TOP: GDP MSC: Applicative 17. Ralph

pays someone to mow his lawn, while Mike mows his own lawn. Regarding

these two practices, which of the following statements is correct? | a. | Only

Ralph's payments are included in GDP. | | b. | Ralph's payments as well as

the estimated value of Mike's mowing services are included in GDP. | | c. |

Neither Ralph's payments nor the estimated value of Mike's mowing services is included in GDP. | | d. | Ralph's payments are definitely included in GDP, while the estimated value of Mike's mowing services is included in GDP | | | only if Mike voluntarily provides his estimate of that value to the government. | ANS: A DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 18. If Susan switches from going to Speedy Lube for an oil change to changing the oil in her car herself, then GDP | a. | necessarily rises. | | b. | necessarily falls. | | c. | will be unaffected because the same service is produced in either case. | | d. | will be unaffected because car maintenance is not included in GDP. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 19. Which of the following is not included in GDP? | a. | carrots grown in your garden and eaten by your family | | b. | carrots purchased at a farmer's market and eaten by your family | | c. | carrots purchased at a grocery store and eaten by your family | | d. | More than one of the above is not included in GDP. | ANS: A DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 20. A professional gambler moves from a state where gambling is illegal to a state where gambling is legal. Most of his income was, and continues to be, from gambling. His move | a. | necessarily raises GDP. | | b. | necessarily decreases GDP. | | c. | doesn't change GDP because gambling is never included in GDP. | | d. | doesn't change GDP because in either case his income is included. | ANS: A DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative 21. If a

state made a previously-illegal activity, such as gambling or prostitution, legal, then, other things equal, GDP | a. | necessarily decreases. | | b. | necessarily increases. | | c. | doesn't change because both legal and illegal production are included in GDP. | | d. | doesn't change because these activities are never included in GDP. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative

22. Which of the following is included in GDP? | a. | medical marijuana purchased from a government-run pharmacy by a glaucoma patient | | b. | recreational marijuana purchased from a drug dealer by a college student | | c. | recreational marijuana produced and consumed by a man in his attic | | d. | All of the above are included in GDP. | ANS: A DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative

23. Marijuana is an illegal good and broccoli is a legal good. Which of the following statements is true? | a. | Darin grows and sells marijuana to Lisa. When Darin and Lisa get married, GDP falls. | | b. | Darin grows and sells marijuana to Lisa. When Darin and Lisa get married, GDP rises. | | c. | Darin grows and sells broccoli to Lisa. When Darin and Lisa get married, GDP falls. | | d. | Darin grows and sells broccoli to Lisa. When Darin and Lisa get married, GDP rises. | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP MSC: Applicative

24. Spots, Inc. produces ink and sells it to Write on Target, which makes pens. The ink produced by Spots, Inc. is called | a. | an inventory good. | | b. | a transitory good. | | c. | a preliminary good. | | d. | an intermediate good. | ANS: D DIF: 1 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Intermediate goods MSC:

Definitional 25. Which of the following statements is correct? | a. | The value of intermediate goods is always included in GDP. | | b. | The value of intermediate goods is included in GDP only if those goods were produced in the previous year. | | c. | The value of intermediate goods is included in GDP only if those goods are added to firms' inventories to be used or | | | sold at a later date. | | d. | The value of intermediate goods is never included in GDP. |

ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Intermediate goods MSC: Interpretive

26. Grapes are | a. | always counted as an intermediate good. | | b. | counted as an intermediate good only if they are used to produce another good, such as wine. | | c. | counted as an intermediate good only if they are consumed. | | d. | counted as an intermediate good, whether they are used to produce another good or consumed. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Intermediate goods MSC: Applicative

27. Gasoline is considered a final good if it is sold by a | a. | gasoline station to a bus company that operates a bus route between San Francisco and Los Angeles. | | b. | pipeline operator to a gasoline station in San Francisco. | | c. | gasoline station to a motorist in Los Angeles. | | d. | All of the above are correct. | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: Intermediate goods MSC: Applicative

28. A steel company sells some steel to a bicycle company for \$150. The bicycle company uses the steel to produce a bicycle, which it sells for \$250. Taken together, these two transactions contribute | a. | \$150 to GDP. | | b. | \$250 to GDP. | | c. | between \$250 and \$400 to GDP, depending on the profit earned by the bicycle company when it sold the

bicycle. | | d. |\$400 to GDP. | ANS: B DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Intermediate

goods MSC: Applicative 29. Al's Aluminum Company sells \$1 million worth of aluminum to Shiny Foil Company, which uses the aluminum to make

aluminum foil. Shiny Foil Company sells \$4 million worth of aluminum foil to households. The transactions just described contribute how much to GDP? |

a. |\$1 million | | b. |\$3 million | | c. |\$4 million | | d. |\$5 million | ANS: C DIF: 2 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of

economics TOP: GDP | Intermediate goods MSC: Applicative 30. One bag of flour is sold for \$1. 00 to a bakery, which uses the flour to bake bread that is

sold for \$3. 00 to consumers. A second bag of flour is sold to a consumer in a grocery store for \$2. 00. Taking these three transactions into account, what

is the effect on GDP? | a. | GDP increases by \$2. 00. | | b. | GDP increases by \$3. 00. | | c. | GDP increases by \$5. 00. | | d. | GDP increases by \$6. 00. |

ANS: C DIF: 3 REF: 23-2 NAT: Analytic LOC: The study of economics and definitions of economics TOP: GDP | Intermediate goods MSC: Analytical 31.

Suppose there are only two firms in an economy: Cowhide, Inc. produces leather and sells it to Couches, Inc., which produces and sells leather

furniture. With each \$1, 000 of leather that it buys from Cowhide, Inc.,

Couches, Inc. produces a couch and sells it for \$3, 000. Neither firm had any inventory at the beginning of 2006. During that year, Cowhide produced

enough leather for 20 couches. Couches, Inc. bought 80% of that leather for \$16, 000 and promised to buy the remaining 20% for \$4, 000 in 2007.

Couches, Inc. produced 16 couches during 2006 and sold each one during that year for \$3, 000. What was the economy's GDP for the 2006? | a. |\$48,

000 | | b. |\$52, 000 | | c. |\$64, 000 | | d. |\$68, 000 | ANS: B DIF: 3 REF: 23-2
NAT: Analytic LOC: The study of economics and definitions of economics TOP:
GDP | Intermediate goods MSC: Analytical 32. Suppose there are only two
firms in an economy: Rolling Rawhide produces rawhide and sells it to Chewy
Chomp, Inc., which uses the rawhide to produce and sell dog chews. With
each \$2 of rawhide that it buys from Rolling Rawhide, Chewy Chomp, Inc.
produces a dog chew and sells it for \$5. Neither firm had any inventory at
the beginning of 2007. During that year, Rolling Rawhide produced enough
rawhide for 1000 dog chews. Chewy Chomp, Inc. bought 75% of that rawhide
for \$1500 and promised to buy the remaining 25% for \$500 in 2008. Chewy
Chomp, Inc. produced 750 dog chews during 2007 and sold each one during
that year for \$5. What was the economy's GDP for 2007? | a. |\$3750 | | b. |
\$4250 | | c. |\$5250 | | d. |\$5750 | ANS: B DIF: 3 REF: 23-2 NAT: Analytic LOC:
The study of economics and definitions of economics TOP: GDP |
Intermediate goods MSC: Analytical 33. In 2007, Corny Company grows and
sells \$2 million worth of corn to Tasty Cereal Company, which makes corn
flakes. Tasty Cereal Company produces \$6 million worth of corn flakes in
2007, with sales to households during the year of \$4. 5 million. The unsold
\$1. 5 million worth of corn flakes remains in Tasty Cereal Company's
inventory at the end of 2007. The transactions just described contribute how
much to GDP for 2007? | a. |\$4. 5 million | | b. |\$6 million | | c. |\$6. 5 million |
| d. |\$8 million | ANS: B DIF: 3 REF: 23-2 NAT: Analytic LOC: The study of
economics and definitions of economics TOP: GDP | Intermediate goods MSC:
Analytical 34. The total sales of all firms in the econo