

D\_\_\_ 1\*\*. Which of the following alternatives describes a transaction that adds directly to U.S. GDP

- (A) A U.S. auto company decides to buy tires to put on its new cars from a U.S. supplier rather than a foreign supplier.
- (B) A homeowner decides to remodel her own basement and purchases materials from a local building supply store.
- (C) A Mexican company located just south of the Texas border buys electric power from a U.S. utility.
- (D) All of the above.

Note that A leads to reduced imports, so GDP rises. C raises exports.

D\_\_\_ 2\*\*. Which statement below is normative?

- (A) The Great Recession is the deepest U.S. economic crisis since the Great Depression
- (B) If job growth does not accelerate soon, the recovery from the Great Recession will likely be labeled as “jobless.”
- (C) The drop in employment at the beginning of the Great Recession was similar to the drop at the beginning of the Great Depression.
- (D) It was necessary for the government to stimulate the U.S. economy in 2009 because of the unusual severity of the Great Recession.

Look for statements that evaluate an outcome rather than predict one. This is a rather subtle question of this kind. The key phrase is “It was necessary.” That’s a judgment about what should happen to make things better rather than a statement about how one action leads to another.

B\_\_\_ 3\*\*. Which alternative below best explains why the value of intermediate goods is excluded from GDP?

- (A) Intermediate goods do not add directly to the social welfare created by production.
- (B) If the value of intermediate were included, some production would be counted multiple times.
- (C) Intermediate goods go into inventories and therefore are part of investment already.
- (D) Intermediate goods are primarily imports and therefore are not produced within a country’s borders.

Fairly straightforward. Intermediate goods add to welfare (a car without tires wouldn’t be very useful!) If intermediate goods are imported then the import contribution to consumption, investment, or government spending would be subtracted in the GDP calculation.

B\_\_\_ 4. Suppose the government undertakes a wasteful “pork barrel” project that no citizen would be willing to pay for based on the true social value of the project. Which alternative below best describes the effect of the project on measured GDP?

- (A) Because the project ultimately creates inflation, it raises nominal GDP, but not real GDP.
- (B) GDP rises by an amount equal to the cost of the project.
- (C) The project has no effect on GDP because it does not add to social welfare.
- (D) The project has no effect on GDP because it is not a final good or service.

Government goods and services are valued at cost, regardless of their true social value (which would almost always be very difficult to measure).

C\_\_\_ 5. Which of the following statements best describes a widely held concern about the recovery from the deep recession that took place between late 2007 and the summer of 2009?

- (A) Although the economy has recovered for over a year, a “double dip” recession has already begun.

- (B) The economy may grow so quickly in 2011 that inflation will accelerate sharply.
- (C) Unemployment will remain unacceptably high for several years.
- (D) Although nominal GDP is growing, the more measure of social welfare, real GDP, is falling.

Alternative C is already true; although that was less obvious when this question was first given in 2011.

B 6. Which of the following scenarios, by itself, leads to a decline in the measured unemployment rate?

- (A) An individual who had not looked for a job for 6 months is encouraged by good economic news to start applying for jobs again.
- (B) A worker retires from firm X and leaves the labor force. The next day, a replacement worker is hired who had applied to firm X for a job two weeks earlier.
- (C) Unusually severe winter weather prevents construction workers from working as many hours as they would in a typical year.
- (D) A college graduate starts looking for work (but does not find a job) in the same month as a long-term unemployed worker becomes discouraged and stops applying for jobs.

Alternative A would raise the labor force, actually increasing unemployment until this person finds a job; C increases the unemployment rate (even after seasonal adjustment); D has no effect on unemployment. B does not change the number of jobs. But it reduces the number of people counted as unemployed.

A 7. Suppose people work more hours outside the home than they would normally choose because their country is at war. In this case,

- (A) GDP growth overstates social welfare because it does not account for the sacrifice of leisure time.
- (B) GDP grows faster as long as it remains below the level of potential output.
- (C) Because of lost home production, GDP rises less than the increase of production for market sales.
- (D) GDP increases if the increase in the cost of pollution from higher production is not greater than the money value of higher output.

C and D are incorrect because neither home production nor environmental degradation due to pollution are counted in GDP in the first place.

C 8 Suppose you were told that the real GDP of the national economy of Fazzaland took 40 years to double in magnitude. Which of the following statements about Fazzaland's long-term annualized growth rate is most accurate?

- (A) Annualized growth rate was 2.5%.
- (B) Annualized growth was more than 2.5%.
- (C) Annualized growth was less than 2.5%.
- (D) Without more information, you cannot be sure how annualized growth compares to 2.5%.

Think about compounding. The correct annualized growth rate is 1.7% ( $2^{1/40} - 1$ ), but you don't need to know this to answer the question. Over a long time, compounding makes a big difference.