

## Macroeconomics

### Questions (T/F, fill-in,etc) on GDP

Dr. McGahagan

Aggregate 1. In macroeconomics, the behavior of all households and firms taken together is referred to as aggregate behavior.

Federal Reserve Economic Data 2. FRED is short for Federal Reserve Economic Data.

National Bureau of Economic Research (NBER) 3. The “recession” periods shown by the shaded areas in FRED graphs are defined by the NBER.

contractions 4. The organization that defines those “recession” periods does not in fact call them “recessions”, but contractions. (Explain the difference between the two terms).

A **contraction** runs from the peak of economic activity to the trough; as soon as the economy begins a recovery, we have an **expansion**. The common language meaning of **recession** implies lower-than-normal economic activity, which can cause confusion, since in the initial stages of a recovery, things will not be “back to normal”. This was very much the case in the recession of 2008-9, when the NBER declared the contraction ended in June of 2009, when economic activity started to turn up; yet the level of economic activity remained below normal for over another year (as of Feb. 2011, the unemployment rate was still a very high 9 percent)

False 5. Most business cycles are symmetrical, that is, booms and “recessions” are of about equal length.

**Recessions are typically shorter.** Check the NBER website for the averages: ([www.nber.org/cycles/cyclesmain.html](http://www.nber.org/cycles/cyclesmain.html)) From 1854 to 2009, there were 33 cycles, with contractions averaging 16 months and expansions lasting 42 months. Note that from 1854 to 1919, contractions were almost as long as average as expansions (22 to 27 months) but from 1945-2009, contractions averaged 11 months, expansions 59 months.

Fine tuning 6. The policy recommendation, popular in the 1960s, that the government could and should precisely regulate the level of inflation and unemployment is called fine tuning.

False 7. A situation of declining employment and high inflation, as in the early 1970s, is referred to as “deflation”.

**Deflation** is negative inflation (falling price levels) ; **“stagflation”** is the correct term for the (rare) combination of recession or stagnation with high inflation.

True 8. The three deepest recessions in the US since 1950 were in progress in the years 1974, 1982, and 2008.

The official dates are Nov. 1973 to March 1975 (16 months) ; July 1981 to Nov. 1982 (16 months); and Dec. 2007 to June 2009 (18 months) – the longest recessions since 1929-1933. The peak unemployment rates around those recessions were in May 1975 (9.0 percent), Nov.-Dec. 1982 (10.8 percent), and October 2009 (10.1 percent) Notice that all these peak rates came at or after the official NBER end of the contraction – and certainly most people think of the economy as being in recession at least until unemployment rates start coming down. (Figures from Bureau of Labor Statistics, <http://bls.gov/data/>)

False 9. The highest inflation rates in the US since 1950 coincided with the recessions mentioned in the last question.

The 1973-5 recession did see high and rising inflation – 8.3 percent in Nov. 1973, rising to a peak of 12.1 percent in Oct. 1974, and still at 10.3 percent in March 1975. But this stagflation is very unusual.

The 1981-2 recession began with quite high inflation (10.8 percent in July 1981) but saw inflation fall to 4.6 percent by the end of the recession. Inflation typically drops during recessions – stores going out of business hold going-out-of-business sales, and workers accept wage cuts. (Inflation as 12-month percent change in CPI for all urban consumers, <http://bls.gov/data/>)

**\_False\_10.** The difference between GDP and GNP is that GDP omits exports and imports from its accounting. Both include imports and exports, although GNP also counts “income receipts from the rest of the world” and “income payments to the rest of the world” as part of its definition of net exports.

In 2010:III, US nominal GDP was 14,745.1 billion and GNP was 14,933.6 billion – because the US had more income from the rest of the world (704.0 billion) than income payments to the rest of the world (515.5 billion) (Source: <http://www.bea.gov>, Table 1.7.5, “Relation of GDP, GNP, NNP, National Income, and Personal Income”, which is a good table to take a look at).

**\_False\_11.** GDP is the total value of final sales of goods and services during a given year.

“Change in business inventories” does not involve a final sale – cars on dealer’s lots, iPads in the stockroom at Walmart, books in Amazon’s warehouse may have been produced this year, but have not yet been sold.

**\_False\_12.** GDP is the total value of all final and intermediate goods produced during a given year.

Only final goods (goods ready for final sale, whether actually sold or in inventory) produced during this year are counted – only the sale of the bread is counted, not the wheat or flour sales which were of course necessary to produce it.

**\_False\_13.** GDP is the total value of all final goods and services produced by American owned factors of production during a given year.

This is the definition of Gross National Product, not Gross Domestic Product.

**\_True\_14.** GDP is greater than GNP in Ireland and Luxembourg, but GDP is less than GNP in India and Mexico.

Ireland and Luxembourg are home to many multinational companies; India and Mexico have many citizens earning incomes abroad.

**\_False\_15.** The difference between Gross Private Domestic Investment and Net Private Domestic Investment is that the value of imports is subtracted from Gross to get the Net.

Depreciation is subtracted from GPDI to get Net Private Domestic Investment.

**\_False\_16.** Gross Private Domestic Investment includes stock market transactions, while Net Private Domestic Investment does not.

Purely financial transactions are not counted in GPDI, NPDI or anywhere else in the National Income and Product Accounts, aside from the services of the stockbrokers, bankers, or other middlemen.

**\_False\_17.** The National Income and Product Accounts (NIPA) are compiled by the Census Bureau.

They are compiled by the Bureau of Economic Analysis ([www.bea.gov](http://www.bea.gov)) of the Department of Commerce.

**\_False\_18.** The two largest items in Government Spending in the NIPA are Medicare and Social Security.

“Government Spending” is officially “Government Consumption Expenditures and Gross Investment”; it counts only direct purchases of goods and services by the government, not transfer payments to individuals who actually spend the Social Security check or who actually incur the medical expenses.

**\_False\_19.** Federal Government spending is much larger than state and local government spending combined.

In 2010, Federal Government spending was 1,214.4 billion (817.4 on defense and 396.6 nondefense) and State and Local spending was 1,788.0 billion.

**\_False\_20.** Nominal GDP adjusts the value of GDP for inflation, and reports each year's GDP in 2005 dollars.

Real GDP is inflation-adjusted and reported in 2005 dollars.

**\_True\_21.** To adjust for inflation, the Bureau of Economic Analysis used (until 1996) a fixed weight procedure in which the prices were fixed in a base year.

Since 1996, a “chain-type” price index, which takes the geometric average of price indexes computed by averaging the price indexes which would result from taking each of two adjacent years as the base year, then translating to 2005 dollars.

**\_D\_22.** The NIPA measure which best reflects average welfare is:

- a. Nominal GDP
- b. Real GDP
- c. Nominal GNP
- d. Real per capita NNP
- e. Aggregate GNP
- f. Nominal per capita GDP

Of course a real per capita measure is best – Real per capita Net National Product, which counts all incomes earned by citizens and adjusts for depreciation, is better than Real per capita GDP.

**\_False\_23.** The Easterlin paradox is that the rich often report themselves as less happy than the poor in any given year, yet over time, increased GDP raises the average level of national happiness.

The richest 25 percent of the population report themselves as happier than the bottom 25 percent in any given year, but the level of happiness over time did not change very much in the data.

**\_True\_24.** Easterlin pointed to the importance of relative status to explain his paradox.

**\_True\_25.** Charles Jones and Peter Klenow developed a social utility function in which not only the level of consumption, but life expectancy, leisure and equality played an important role.

**\_False\_26.** In the Jones-Klenow model, GDP turned out to have little to do with overall welfare.

Jones and Klenow found that their wider measure of social utility had a very high correlation with GDP per capita (a correlation coefficient of .95, with + 1.0 being a perfect positive correlation). They did however find that there was a great deal of variance in welfare at any given level of GDP.

**\_Tricky\_27.** Most economists think that Gross National Income (GNI) would be a better measure of welfare than GDP or GNP.

This question is true if you stop reading at GDP – GNI counts all incomes, including those earned abroad. But since GNI and GNP are identical, it can't be better than GNP. (This is not one I will ask on the exam)

**\_False\_28.** In recent years, average per capita real GDP has risen more slowly than median per capita real disposable income.

Median per capita real disposable income has risen more slowly than average per capita real GDP. Average per capita real GDP rose from \$ 20,820 in 1970 to \$ 42,723 in 2010 – roughly doubled (more exactly, rose 103 percent), according to BEA NIPA table 7.1. Both figures are given in 2005 dollars.

Median per household real disposable income, according to the Census Bureau's *Income, Poverty and Health Insurance Coverage in the United States, 2009* (by Carmen DeNavas-Walt et al., Sept. 2010), rose from \$ 43,055 to \$ 49,777 dollars. Note that this is in 1977 dollars, since that is the base year of the CPI-U-RS series that they use for consistency. The average household size was 3.11 in 1970 and 2.59 in 2008-9, so this could be placed on a per capita basis by dividing median income by household size:

$$\$ 43,055 / 3.11 = \$ 13, 844 \text{ in } 1970$$

$$\$ 49,777 / 2.59 = \$ 19, 219 \text{ in } 2009$$

This falls well short of doubling – median household income increased by under 40 percent during the period.