

EC1001 – Macroeconomics – Question Sheet 1 – Week 16

Instructions: Prepare the answer to these questions in advance of the class, and be ready to discuss them during the class. You may prepare written notes, which you can use in the classes. However, you may not read from the notes: the class is a discussion, not a demonstration of reading ability. You will be assessed by your class tutor on the basis of your participation in the class. You are **not** required to hand in any written answers to these questions, and if you hand them in they will not be marked. All questions are slight adaptations from the corresponding questions in the recommended textbook for this course, *Economics*, Second Edition, by N. Gregory Mankiw and Mark P. Taylor, with the relevant chapter indicated.

Notes for students: the questions in the class this week will focus on chapters 25 and 26, as this is the material which we have most recently covered in the lectures. But, at the bottom of this question sheet, I also include some supplementary questions from Chapters 23 and 24. If time permits, you should try to look at these questions too, since they are again the sort of question that can come up in the examination.

Ch25.1 Why is productivity related to the standard of living? In your answer be sure to explain what productivity and standard of living mean. Make a list of things that determine labour productivity.

Ch25. 2. What is the difference between human capital and technology?

Ch25.3 Some data that at first might seem puzzling: The share of GDP devoted to investment was similar for the United States and South Korea from 1960-1991. However, during these same years South Korea had a 6 percent growth rate of average annual income per person, while the United States had only a 2 percent growth rate. If the saving rates were the same, why were the growth rates so different?

Ch25.4 Suppose that the UK Government decided to reduce consumption and increase investment.

- a. How would this change affect economic growth?
- b. What groups in society would benefit from this change? What groups might be hurt?

Ch 26.1 Investment can be increased both by reducing taxes on private saving and by reducing the government budget deficit.

- a. Why is it difficult to implement both of these policies at the same time?

- b. What would you need to know about private saving in order to judge which of these two policies would be a more effective way to raise investment?

Ch26.2. What are the basic differences between bonds and stocks?

The questions on the next page are supplementary ones. It is not compulsory for you to have looked at them ahead of the class, as your tutors will focus in the class on the questions above. However, it is in your own interests, when you have time, to work through these supplementary questions. In addition, your tutor may decide to drop a question or two from this supplementary list into the class discussion, if you have made good progress on the main questions above.

If time and interest permit, here are some questions from Chapters 23 and 24 in Mankiw-Taylor. Again it is helpful for students to work through these; again they are the sort of question that can come up in the exam.

Ch23.1. 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.

Ch23 2. If prices rise, people's income from selling goods increases. The growth of real GDP ignores this gain, however. Why, then, do economists prefer real GDP as a measure of economic wellbeing?

Ch23.3 If GDP is a good measure of well-being, why is Switzerland's GDP so much lower than India's GDP or China's GDP?

Ch23 4. What components of GDP (if any) would each of the following transactions affect? Explain.

- a) A family buys a new refrigerator.
- b) Aunt Jane buys a new house.
- c) BMW sells a Mini from its inventory.
- d) You buy fish and chips.
- e) Leicester City Council resurfaces University Road.
- f) Your parents buy a bottle of French wine.

Ch23. 5 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?

Ch24. 1. In a simple economy, people consume only 2 goods, food and clothing. The market basket of goods used to compute the CPI consists of 50 units of food and 10 units of clothing.

	Food	Clothing
2002 price per unit	\$4	\$10
2003 price per unit	\$6	\$20

- a. What are the percentage increases in the price of food and in the price of clothing?
- b. What is the percentage increase in the CPI?
- c. Do these price changes affect all consumers to the same extent? Explain.

Ch24.2 Which of the problems in the construction of the CPI index might be illustrated by each of the following situations? Explain.

- a. the invention of MP3 players
- b. the introduction of air bags in cars
- c. increased personal computer purchases in response to a decline in their price
- d. increased use of digital cameras
- e. greater use of fuel-efficient cars after petrol prices increase.

Ch24.3. Why does the GDP deflator give a different rate of inflation than the CPI?

Ch24. 4. Jay and Joyce meet George, the banker, to work out the details of a mortgage. They all expect that inflation will be 2 percent over the term of the loan, and they agree on a nominal interest rate of 6 percent. As it turns out, the inflation rate is 5 percent over the term of the loan.

- a. What was the expected real interest rate?
- b. What was the actual real interest rate?
- c. Who benefited and who lost because of the unexpected inflation?