

Econ_101_Fall_06_IVY Tech College
Homework 06: Solutions

Chapter 10

1. Should we care more about the growth of nominal GDP or real GDP?
Real GDP measures output of goods and services. Therefore, it is the more important measure for economic growth.

For Problems 2-4, use the following data:

	Quantities Produced		Prices	
	CDs	Tennis Racquets	CDs	Tennis Racquets
Year 2004	100	200	20	110
Year 2005	120	210	22	120

2. Calculate real GDP using prices from 2004. By what percent did real GDP grow?
Real GDP for 2004 = 24000. Real GDP for 2005 = 25500. Growth = 6.25%
3. Calculate the value of the price index for GDP for 2005 using 2004 as the base year. By what percent did prices increase?
Nominal GDP for 2005 = 27840. GDP deflator for 2005 = $100 \times (27840/25500) = 109.18$
4. Are unemployment benefits included in GDP?
No. Transfer payments are not included. Only the values of final goods and services produced domestically are included.
5. Suppose someone told you that the value of a price index in a country was 115. Is this information, by itself, useful?
Not particularly. All this tells you is that prices in that country are 15% higher than they were in some unspecified year.
6. A student once said, "Trade deficits are good because we are buying more goods than we are producing." What is the downside to trade deficits?
To run a trade deficit, a country must sell some of its assets to foreign citizens
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8. A publisher buys paper, ink, and computers to produce textbooks. Which of these purchases is included in investment spending?
Computers. The other items are intermediate goods.

9. Air quality in Los Angeles deteriorated in the 1950s –1970s and then improved in the 1980s and 1990s. How could this change in air quality be incorporated into our measures of national income?

It would require valuing clean air. This might be possible using the price of pollution permits.

Chapter 11

1. Here is some data for an economy:

10 million individuals 16 years and older

5.5 million employed

0.5 million unemployed

Calculate the labor force, the labor force participation rate, and the unemployment rate for this economy.

Labor force = 6 million

Labor force participation = 60%

Unemployment rate = 8.33%

2. Sometimes at the beginning of an economic boom, total employment increases sharply but the unemployment rate does not fall. Why might this occur?

As the economy heads into a boom, more people enter the labor force as opportunities for employment increase.

3. In inner cities, minority youth have high unemployment rates. Many economists believe that the unemployment picture is even worse than the statistics portray? What could be the basis for this belief?

When there is little hope of getting a job, people become discouraged and stop looking for a job. They are, therefore, not counted as part of the labor force, reducing the measured unemployment rate.

4. Suppose that the government decided that housewives and househusbands should be counted as employed because they perform important services. How do you think this change would affect our measure of the labor force, the labor force participation rate, and the unemployment rate? (You may want to construct a numerical example). The measured labor force would rise. The labor force participation rate would increase. The unemployment rate would fall.

6. When oil prices increased sharply in the 1970s, some businesses were affected much more adversely than others. Explain why some economists believe that the oil price increase led to higher frictional unemployment.

When oil prices rose, people were laid off in the 1970s. If those people took time to find new employment opportunities, they were considered frictionally unemployed.

8. A job paid \$3,000 in 1960. The CPI in 1960 was 29.3 compared to 164 in 1999. What salary would be comparable in real terms in 1999?

$$3000/29.3 = ?/164 \Rightarrow ? = 164 * 3000 / 29.3 = 16791.81.$$

9. An Economy has 100 million people employed, 8 million unemployed, and 4 million discouraged workers. What is the conventional measure of the unemployment rate? What would be the best alternative measure that takes into account discouraged workers?

The conventional unemployment rate is 7.4% (8/108). An alternative measure would be to add the discouraged workers to total unemployment. This would also increase the labor force by an equal amount. This alternative measure would be 10.7% (12/112).