Week 1 Tutorial Solution
ECON203: Macroeconomics 2
Dr. Lei Pan — Semester 2, 2019
Australian Catholic University — Tutorial Time: 02/08/2019

Multiple Choice Questions

Question 1. The two major reasons for the tremendous growth in output in the U.S. economy over the last 125 years are
(a) population growth and low inflation.
(b) population growth and increased productivity.
(c) low unemployment and low inflation.
(d) low inflation and low trade deficits.

Answer: B

Question 2. The main reason that the United States has such a high standard of living is
(a) low unemployment.
(b) high average labour productivity.
(c) low inflation.
(d) high government budget deficits.

Answer: B

Question 3. Average labour productivity is the
(a) amount of workers per machine.
(b) amount of machines per worker.
(c) ratio of employed to unemployed workers.
(d) amount of output per worker.

Answer: D

Question 4. The most direct effect of an increase in the growth rate of average labour productivity would be an increase in
(a) the inflation rate.
(b) the unemployment rate.
(c) the long-run economic growth rate.
(d) imported goods.

Answer: C

Question 5. Short-run contractions and expansions in economic activity are called
(a) recessions.
(b) expansions.
(c) deficits.
(d) the business cycle.

Answer: D

Question 6. When national output rises, the economy is said to be in
(a) an expansion.
(b) a deflation.
(c) an inflation.
(d) a recession.

Answer: A

Question 7. Which of the following best describes a typical business cycle?
(a) Economic expansions are followed by economic contractions.
(b) Inflation is followed by unemployment.
(c) Trade surpluses are followed by trade deficits.
(d) Stagflation is followed by inflationary economic growth.

Answer: A

Question 8. The number of unemployed divided by the labour force equals
(a) the inflation rate.
(b) the labour force participation rate.
(c) the unemployment rate.
(d) the misery index.

Answer: C

Question 9. The highest and most prolonged period of unemployment in the United States over the last 125 years occurred during
(a) World War II.
(b) the 1890s Depression.
(c) the 1990-1991 recession.
(d) the Great Depression of the 1930s.

Answer: D

Question 10. A country is said to be experiencing inflation when
(a) prices of most goods and services are rising over time.
(b) prices of most goods and services are falling over time.
(c) total output is rising over time.
(d) total output is falling over time.

Answer: A

Problem Solving Questions

Question 11. List and briefly explain the three lessons that describe how the economy as a whole works.

The three lessons that describe how the economy as a whole works are:
a. A country's standard of living depends on its ability to produce goods and services.

b. Prices rise when the government prints too much money.
c. Society faces a short-term trade-off between inflation and unemployment.

A country's standard of living depends on its ability to produce goods and services, which, in turn, depends on its productivity, which is a function of the education and skills of workers and the access workers have to the necessary tools and technology. Prices rise when the government prints too much money because too much money is chasing too few goods. The rise in the general price level is called inflation. Society faces a short-run trade-off between inflation and unemployment because some prices are sticky, so that a change in policy can affect spending, causing unemployment to change in the opposite direction of a change in inflation, until prices have fully adjusted to the change.

Question 12. What two things does gross domestic product (GDP) measure? How can it measure two things at once?

Gross domestic product measures two things at once: (1) the total income of everyone in the economy; and (2) the total expenditure on the economy's output of goods and services. It can measure both of these things at once because income must equal expenditure for the economy as a whole.

Question 13. Why should policymakers care about GDP?

Although GDP is not a perfect measure of wellbeing, policymakers should care about it because a larger GDP means that a nation has the ability to provide better health care, better educational systems and more of the material necessities of life.

Question 14. Can average labour productivity fall even though total output is rising? Can the unemployment rate rise even though total output is rising?

Yes, average labour productivity can fall even when total output is rising. Average labour productivity is total output divided by employment. So average labour productivity can fall if output and employment are both rising but employment is rising faster.

Yes, the unemployment rate can also rise even though total output is rising. This can occur a number of different ways. For example, average labour productivity might be rising with employment constant, so that output is rising; but the labour force may be increasing as well, so that the unemployment rate is rising. Or average labour productivity might be constant, and both employment and unemployment could rise at the same time because of an increase in the labour force, with the number of unemployed rising by a greater percentage.

Question 15. Prices were much higher in the United States in 2012 than in 1890. Does this fact mean that people were economically better off in 1890? Why or why not?

Just because prices were lower in 1890 than they were in 2012 does not mean that people were better off back then. People's incomes have risen much faster than prices have risen over the last 100 years, so they are better off today in terms of real income.

Question 16. Which of the following statements are positive in nature and which are normative?

a. A tax cut will raise interest rates.

Positive. This statement tells what *will* happen, not what *should* happen.

b. A reduction in the payroll tax would primarily benefit poor and middle-class workers.

Positive. Even though it is about income-distribution issues, it is a statement of fact, not opinion. If the statement said "The payroll tax should be reduced because it..." then it would be a normative statement.

c. Payroll taxes are too high.

Normative. Saying taxes are too high suggests that they *should* be lower.

d. A cut in the payroll tax would improve the President's popularity ratings.

Positive. Says what *will happen* as a consequence of an action, not what *should be done.*

e. Payroll taxes should not be cut unless capital gains taxes are also cut.

Normative. This is a statement of preference about policies.