Exam II Study Questions

A. Direct Questions

1. What is the relationship between a price index and an inflation rate?
2. Explain (but not in great detail) how the Consumer Price Index is constructed.
3. How is it that reported inflation rates in earlier years may have overstated the actual level of inflation in the economy?
4. What is an index number, and how is an index number constructed?
5. What are the standards applied to determine if someone is counted as unemployed?
6. What are the differences between structural, frictional, and cyclical unemployment?
7. What is a “discouraged worker”, and how are discouraged workers included in calculating national unemployment rates?
8. How is it that the reported unemployment rate may actually understate the actual level of unemployment in the economy?
9. Define Gross Domestic Product and explain the significance of each of the separate terms that goes into the definition.
10. What are the expenditure components used in calculating GDP?
11. What are the income components used in calculating GDP?
12. How is it that GDP can (theoretically) be measured by either an incomes approach or an expenditures approach?
13. What is Real GDP (RGDP), and why is it such an important measure of economic activity?
14. What is the relationship between GDP, RGDP and the price level?
15. Explain how real economic growth is calculated in an economy.
16. How can GDP and RGDP move in opposite directions in two consecutive years?
17. Why is Aggregate Demand a negatively sloped function? What are the similarities in the factors used to explain downward sloping Aggregate Demand and downward sloping Demand functions?
18. Why is Aggregate Supply an positively sloped function? What are the similarities in the factors used to explain upward sloping Aggregate Supply and upward sloping Supply functions?
19. What are the factors that lead to a shift in Aggregate Demand or Aggregate Supply?
20. In the Aggregate Demand - Aggregate Supply analysis, what is the relationship between RGDP and the Unemployment Rate?
Problems:

1. Suppose you are given the following CPI data for the 1990s (textbook, page 117)

<table>
<thead>
<tr>
<th>Year</th>
<th>CPI</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>136.2</td>
</tr>
<tr>
<td>1992</td>
<td>140.3</td>
</tr>
<tr>
<td>1993</td>
<td>144.5</td>
</tr>
<tr>
<td>1994</td>
<td>148.2</td>
</tr>
<tr>
<td>1995</td>
<td>152.4</td>
</tr>
<tr>
<td>1996</td>
<td>156.9</td>
</tr>
</tbody>
</table>

a. What is the inflation rate for 1993?
b. What is the average inflation rate for Bill Clinton’s first term in office?
c. Convert the numbers in the table to a 1993 base year.

2. Imagine an Aggregate Demand - Aggregate Supply diagram that shows an initial national macroeconomic equilibrium between Real GDP (RGDP) and an aggregate price level. Show how the events described below would shift AD or AS, and state the impact of the event on RGDP and on the price level. Each case involves a modification of the original graph. Analyze each case independently of each of the other cases.

   a. The U.S. Congress authorizes an increase in government purchases of weapons and munitions to assist in the ongoing efforts of Cuban rebels to overthrow Cuban president Fidel Castro.

   b. Labor costs rise substantially as a new national labor union movement succeeds in unionizing a large number of previously non-union employees.

   c. Congress passes and President Bush signs a huge income tax decrease designed to bring the economy out of its longest recession since the Great Depression.

   d. Further enhancements to fluid chip manufacturing technologies results in record productivity increases in the U.S. manufacturing sector.

   e. The U.S. Congress passes (and President Bush signs) a defense spending bill that increases the number of active duty military personnel by ten percent.