Practice Questions for Midterm 1

Components of GDP
For each, indicate the dollar value that each contributes to each component of GDP. Assume that everyone in society gets paid a wage of $10 per hour for their market labor. If an item does not contribute to GDP, write “none”:

<table>
<thead>
<tr>
<th></th>
<th>C</th>
<th>I</th>
<th>G</th>
<th>NX</th>
</tr>
</thead>
</table>

a) Households spend 10,000 hours taking care of children. Of these, 8,000 hours are parents taking care of their own children, and 2,000 hours are spent on outside child care. 20,000 ___ ___ ___ ___

b) Workers spend 12,000 hours on cleaning. Of these, 7,000 hours are spent cleaning their own homes, 2,000 hours are spent cleaning other people’s homes and 3,000 hours are spent cleaning businesses. 20,000 ___ ___ ___ ___

c) Businesses hire 4,000 hours of telephone technical support. Of these, 3,000 hours are by domestic firms and 1,000 hours are by foreign firms. ___ ___ ___ -10,000

d) The government hires 4,000 hours of law enforcement personnel. ___ ___ 40,000 ___

e) Domestic businesses spend $10,000 on imported asparagus. They sell the asparagus to households for $25,000. 25000 ___ ___ -10,000

f) The government collects $50,000 in taxes. Of this, $40,000 is spent on food stamp programs and $10,000 is used to pay tax collectors. ___ ___ 10,000 ___

g) Firms import $10,000 of copper. They use half to make electronics, which they sell to the government for $20,000, and the other half is stored for next year. ___ 5,000 20,000 -10,000

h) Better technology reduces time spent cooking at home by 4,000 hours. ___ ___ none ___ ___
Questions from Lectures

a. What do IMF and WTO stand for?
b. What are the functions of the IMF, World Bank and WTO?
c. What is the difference between the loans that the World Bank and IMF give?
d. What does the term “globalization” mean? What are some criticisms of globalization?
e. What are the differences between the CPI, PPI and GDP deflator?
f. What are some similarities between the government policies of South Korea and Argentina over the last century? What are some differences?
g. What is the “Law of One Price”?
h. What is “Purchasing Power Parity”?
i. What is the “Big Mac Index” and why is it useful?
j. What did Solow find to be the most important contribution to economic growth in the US and most other countries?
k. What measure of income do we use for comparisons across countries and over time? By this measure, what has the long term growth rate of the US been?
l. What are some similarities and differences in the growth experiences of South Korea and China?
m. Why is China’s growth important relative to the experiences of fast growth in other countries?

n. What is “laissez faire”? What are some arguments in favor of laissez faire economic policies?
o. What does it mean for one currency to “appreciate” against another?
p. What is the international allocation puzzle? What are some possible resolutions?
q. What are foreign direct and foreign portfolio investment?
r. What is “capital flight”?
s. What are “pegged” and “floating” exchange rate regimes?
t. What are the benefits and risks of having a pegged currency?
u. What is the “Unholy Trinity Theorem”?
v. What happened to interest rates on European debt before the adoption of the Euro, from 2002-08, and after the European debt crisis?
w. How did the UK avoid a financial crisis?
Numerical Example

Suppose the following is a summary of everything produced in the US and France in 2001 and 2002:

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th></th>
<th>2002</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Prices</td>
<td>Quantities</td>
<td>Prices</td>
<td>Quantities</td>
</tr>
<tr>
<td>US Cheese</td>
<td>50</td>
<td>100</td>
<td>50</td>
<td>140</td>
</tr>
<tr>
<td>US Wine</td>
<td>100</td>
<td>50</td>
<td>155</td>
<td>40</td>
</tr>
<tr>
<td>French Cheese</td>
<td>60</td>
<td>40</td>
<td>78</td>
<td>50</td>
</tr>
<tr>
<td>French Wine</td>
<td>60</td>
<td>60</td>
<td>100</td>
<td>60</td>
</tr>
<tr>
<td>$ per Euro</td>
<td>1.25</td>
<td></td>
<td>1.55</td>
<td></td>
</tr>
</tbody>
</table>

Fill out the following table:

The consumption basket in both countries is 1 unit of wine and 1 unit of cheese. The base year is 2001 in both countries. Desired units are indicated.

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th></th>
<th>2002</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>US</td>
<td>France</td>
<td>US</td>
<td>France</td>
</tr>
<tr>
<td>Nominal GDP,</td>
<td>10000</td>
<td>6000</td>
<td>13200</td>
<td>9900</td>
</tr>
<tr>
<td>home currency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP,</td>
<td>10000</td>
<td>6000</td>
<td>11000</td>
<td>6600</td>
</tr>
<tr>
<td>home currency</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP Deflator</td>
<td>100</td>
<td>100</td>
<td>120</td>
<td>150</td>
</tr>
<tr>
<td>CPI, home currency</td>
<td>100</td>
<td>100</td>
<td>136.67</td>
<td>148.33</td>
</tr>
<tr>
<td>Real Exchange Rate, US Wine per French Wine</td>
<td>0.75</td>
<td></td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

a) Did the US Dollar have a nominal exchange rate appreciation or depreciation against the euro in 2002?  **depreciate**
d) What are the real and nominal growth rates of GDP in the US in 2002? In France?  **US: real = 10%; nominal = 32%; France: real = 10%, nominal = 65%**
Capital Flows Examples

In each situation, answer each of the following questions: (a) which curve shifts, (b) which direction does it shift, (c) how are interest rates affected, (d) how are net capital outflows affected, (e) how is the exchange rate affected?

1. Life expectancy increases, so people save more for retirement.
2. The domestic government introduces new subsidies on investment.
3. Foreigners become worried that the domestic country is not a safe place to invest.
4. The domestic government reduces tariffs on foreign imports.
5. Foreign governments reduce tariffs on their imports from the domestic country.
6. The domestic government raises taxes on dividends paid to domestic households.
7. Interest rates decrease in foreign countries.
8. Domestic investors become worried about the domestic economy and stop building new factories.

ANSWERS:

1. Supply of LF; right; down; up; down
2. Demand for LF; right; up; down; up
3. NCO and Demand for LF; both right; up; up; down
4. Demand for Exchange (NX); left; same; same; down
5. Demand for Exchange (NX); right; same; same; up
6. Supply of LF; left; up; down; up
7. NCO and Demand for LF; both left; down; down; up
8. Demand for LF; left; down; up; down