Chapter 5

MEASURING GDP AND ECONOMIC GROWTH*

**Gross Domestic Product**

**Topic: GDP**

**Skill: Recognition**

1) Gross domestic product is the total ____ produced within a country in a given time period.
   A) market value of all final and intermediate goods and services
   B) market value of all final and intermediate goods and services plus investment and depreciation
   C) amount of final and intermediate goods and services
   D) market value of all final goods and services

   **Answer:** D

**Topic: Circular Flow**

**Skill: Conceptual**

2) The circular flow diagram shows
   A) how nominal GDP is distinct from real GDP.
   B) how the prices of factors are determined.
   C) the effects of inflation in a simple economy.
   D) the flows between different sectors of the economy.

   **Answer:** D

**Topic: Circular Flow, Aggregate Expenditure**

**Skill: Conceptual**

3) The circular flow diagram indicates that
   A) households sell the services of factors of production to firms.
   B) firms buy the services of factors of production from the government.
   C) households sell goods and services to the government.
   D) firms buy goods and services from households.

   **Answer:** A

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* This is Chapter 21 in *Economics.*
**Topic: Government Budget Deficit**  
**Skill: Recognition**

7) The government’s budget deficit is the excess of government
   A) purchases of goods and services over its interest
      payments on the government debt.
   B) purchases of goods and services over its net
      taxes.
   C) net taxes over its purchases of goods and services.
   D) interest payments on the government debt over
      its net taxes.

**Answer: B**

**Topic: Rest of the World Sector**  
**Skill: Conceptual**

8) If U.S. imports are less than U.S. exports, the
   A) rest of the world borrows from the U.S. economy.
   B) U.S. economy borrows from the rest of the
      world.
   C) U.S. government has a budget surplus.
   D) U.S. government has a budget deficit.

**Answer: A**

9) If the rest of the world lends to the U.S. economy,
   A) the U.S. government has a budget surplus.
   B) the U.S. government has a budget deficit.
   C) U.S. imports are less than U.S. exports.
   D) U.S. imports exceed than U.S. exports.

**Answer: D**

10) When exports from the United States exceed imports
    into the United States, the rest of the world
    A) borrows from the United States or sells U.S. assets.
    B) lends to the United States or sells U.S. assets.
    C) borrows from the United States or buys U.S. assets.
    D) lends to the United States or buys U.S. assets.

**Answer: A**

**Topic: Rest of the World Sector**  
**Skill: Conceptual**

11) When imports into the United States exceed exports
    from the United States, the United States
    A) borrows from the rest of the world or sells foreign assets.
    B) lends to the rest of the world or sells foreign assets.
    C) borrows from the rest of the world or buys foreign assets.
    D) lends to the rest of the world or buys foreign assets.

**Answer: A**

**Topic: Expenditure Equals Income**  
**Skill: Conceptual**

12) Which of the following are equal to one another?
    I. aggregate production
    II. aggregate expenditure
    III. aggregate income
    A) I equals II, but not III.
    B) I equals III, but not II.
    C) II equals III, but not I.
    D) I equals II equals III.

**Answer: D**

**Topic: How Investment Is Financed**  
**Skill: Recognition**

13) Investment is financed by which of the following?
    I. Government spending
    II. National saving
    III. Borrowing from the rest of the world
    A) I, II, and III
    B) I and II only
    C) I and III only
    D) II and III only

**Answer: D**

**Topic: National Saving**  
**Skill: Recognition**

14) National saving is defined as the amount of saving by
    A) businesses.
    B) households.
    C) businesses and households.
    D) businesses and households and the government.

**Answer: D**
Topic: National Saving
Skill: Recognition
15) National saving equals
A) household saving + business saving.
B) household saving + business saving + govern-
ment saving.
C) household saving + business saving + net taxes –
government purchases of goods and services.
D) Both answers B and C are correct.
Answer: D

Topic: National Saving
Skill: Recognition
16) National saving is defined as
A) the total amount of household saving.
B) personal saving by households and businesses
plus government saving.
C) the saving by the federal government.
D) None of the above answers are correct.
Answer: B

Topic: National Saving
Skill: Conceptual
17) If the government runs a budget deficit, then
A) national saving is negative.
B) household but not business saving must pay for
the deficit.
C) part of household and business saving finances
the deficit.
D) national saving cannot fund investment.
Answer: C

Topic: National Saving
Skill: Analytical
18) If national saving ($S$) is $100,000, net taxes ($T$)
equal $100,000 and government purchases of
goods and services ($G$) are $25,000, how much
are households and businesses saving?
A) $25,000.
B) $225,000.
C) $-25,000.
D) None of the above.
Answer: A

Topic: Borrowing from the Rest of the World
Skill: Recognition
19) Suppose the U.S. spends more on foreign goods
and services than foreigners spend on our goods
and services and the U.S. sells no foreign assets.
Then
A) the United States must borrow an amount equal
to national saving.
B) the United States must borrow an amount equal
to imports minus exports.
C) the rest of the world may or may not finance the
U.S. trade deficit.
D) the United States must borrow an amount equal
to consumption expenditure plus investment.
Answer: B

Topic: Borrowing from the Rest of the World
Skill: Conceptual
20) If foreigners spend more on U.S.-made goods and
services than we spend on theirs,
A) foreigners must borrow from the United States
or sell U.S. assets to make up the difference.
B) all U.S. national saving remains in the United
States
C) we must borrow from foreigners because of low
imports.
D) funds flow in from abroad to help finance U.S.
investment.
Answer: A

Topic: Borrowing from the Rest of the World
Skill: Analytical
21) If our exports are $1.2 billion and our imports are
$1.7 billion,
A) the United States is lending to the rest of the
world.
B) U.S. national saving is too high.
C) the United States is borrowing from the rest of
the world.
D) U.S. investment must decrease.
Answer: C
22) A feature of a stock variable and a flow variable is that
A) a stock is a quantity per unit of time and a flow is a quantity that exists at a point in time.
B) a stock is a quantity that exists at a point in time and a flow is a quantity per unit of time.
C) a stock only measures the value of goods and services produced in a country during a given time period.
D) an example of a stock variable is real GDP and an example of a flow variable is consumption expenditure.
Answer: B

23) Which of the following is a stock variable?
A) Investment.
B) Income.
C) Wealth.
D) Saving.
Answer: C

24) GDP is
A) a measure of the amount of government debt.
B) investment in the nation’s economy.
C) stock.
D) flow.
Answer: D

25) Which of the following is a flow variable?
A) investment.
B) capital.
C) the amount of money in your savings account.
D) the number of CD’s you own.
Answer: A

26) Which of the following is NOT a flow variable?
A) The number of DVD players sold per month.
B) The number of DVDs available at the library.
C) Annual spending on DVD rentals.
D) The number of DVDs produced per year.
Answer: B

27) Which of the following is a flow variable?
A) Capital.
B) Gross domestic product.
C) Wealth.
D) The money in your pocket.
Answer: B

28) An example of a flow variable is
A) capital.
B) consumption expenditure by households.
C) the machinery owned by a firm.
D) the cash held by households.
Answer: B

29) Which of the following is a stock variable?
A) Capital.
B) Consumption expenditure by households.
C) Gross investment.
D) Depreciation.
Answer: A

30) An example of a stock quantity is
A) real GDP.
B) consumption expenditure by households.
C) gross investment.
D) wealth.
Answer: D

31) Which of the following is FALSE about saving?
A) Saving adds to wealth.
B) Income left after paying taxes can either be consumed or saved.
C) Saving equals wealth minus consumption expenditures.
D) Saving is a flow variable.
Answer: C
Topic: **Wealth and Saving**  
**Skill: Analytical**

32) At the beginning of the year, your wealth is $10,000. During the year, you have an income of $90,000 and you spend $80,000 on consumption. You pay no taxes. Your wealth at the end of the year is

A) $20,000.00.  
B) $0.  
C) $90,000.00.  
D) $100,000.00.

**Answer: A**

33) At the beginning of the year, your wealth is $10,000. During the year, you have an income of $80,000 and you spend $90,000 on consumption. You pay no taxes. Your wealth at the end of the year is

A) $20,000.00.  
B) $0.  
C) $90,000.00.  
D) $100,000.00.

**Answer: B**

Topic: **Capital and Investment**  
**Skill: Recognition**

34) The term capital, as used in macroeconomics, refers to

A) the plant, equipment, buildings, and inventories of raw materials and semi-finished goods.  
B) financial wealth.  
C) the sum of investment and government purchases of goods.  
D) investment.

**Answer: A**

35) The term capital, as used in macroeconomics, includes all of the following except

A) inventories.  
B) equipment.  
C) buildings.  
D) a company’s work force.

**Answer: D**

36) The term capital, as used in macroeconomics, includes all of the following except

A) inventories.  
B) equipment.  
C) buildings.  
D) a company’s work force.

**Answer: D**

37) Capital

A) includes the plant, equipment, and buildings owned by firms.  
B) increases when depreciation increases.  
C) does not include semifinished goods used to produce other goods and services.  
D) is a flow variable.

**Answer: A**

38) Depreciation

A) does not change the level of capital in the economy.  
B) is the decrease in the capital stock because of wear and tear.  
C) is also known as capital consumption.  
D) Both answers B and C are correct.

**Answer: D**

39) Investment, as defined in the text, refers to the purchase of

A) new capital.  
B) stocks and bonds.  
C) durable goods by consumers.  
D) All of the above answers are correct.

**Answer: A**

40) Which of the following is not included in the investment component of GDP?

A) A household purchases a new washing machine.  
B) Purchase of new equipment by a business.  
C) A firm builds a new warehouse.  
D) A business fails to sell all of its output and therefore experiences an increase in inventories.

**Answer: A**
Topic: Capital and Investment  
Skill: Recognition  
41) Gross investment  
A) is the purchase of new capital.  
B) includes only replacement investment.  
C) does not include additions to inventories.  
D) Both answers A and B are correct.  
Answer: A  

Topic: Capital and Investment  
Skill: Recognition  
42) The total amount spent on adding to the stock of capital and on replacing depreciated capital is  
A) capital consumption.  
B) gross investment.  
C) depreciation.  
D) the net stock of investment.  
Answer: B  

Topic: Capital and Investment  
Skill: Recognition  
43) The total amount spent on adding to the stock of capital and on replacing depreciated capital is  
A) consumption on new capital.  
B) depreciation.  
C) gross investment.  
D) net investment.  
Answer: C  

Topic: Capital and Investment  
Skill: Recognition  
44) Economists define depreciation as  
A) the decrease in the capital stock from wear and tear and obsolescence.  
B) the loss in stock market of a company’s value.  
C) the drop in the price of a company’s product.  
D) All of the above answers are correct.  
Answer: A  

Topic: Capital and Investment  
Skill: Recognition  
45) Depreciation is  
A) the sum of gross and net investment.  
B) a stock variable that affects the economy’s ability to produce.  
C) the difference between gross investment and the capital stock.  
D) one of the flow variables affecting the capital stock.  
Answer: D  

Topic: Capital and Investment  
Skill: Conceptual  
46) If the economy’s capital stock increases over time,  
A) net investment is positive.  
B) depreciation is less than zero.  
C) depreciation exceeds gross investment.  
D) gross investment equals depreciation.  
Answer: A  

Topic: Capital and Investment  
Skill: Conceptual  
47) If the economy’s capital stock decreases over time,  
A) net investment is positive.  
B) depreciation is less than zero.  
C) depreciation exceeds gross investment.  
D) gross investment equals net investment.  
Answer: C  

Topic: Capital and Investment  
Skill: Analytical  
48) The Acme Stereo Company had a capital stock of $24 million at the beginning of the year. At the end of the year, the firm had a capital stock of $20 million. Thus its  
A) net investment was some amount but we need more information to determine the amount.  
B) net investment was $4 million for the year.  
C) gross investment was zero.  
D) net investment was –$4 million for the year.  
Answer: D  

Topic: Capital and Investment  
Skill: Analytical  
49) At the beginning of the year, Tom’s Tubes had a capital stock of 5 tube inflating machines. During the year, Tom scrapped 2 old machines and purchased 3 new machines. Tom’s net investment for the year totaled  
A) 1 machine.  
B) 2 machines.  
C) 3 machines.  
D) 6 machines.  
Answer: A
50) At the beginning of the year, Tom’s Tubes had a capital stock of 5 tube inflating machines. During the year, Tom scrapped 2 old machines and purchased 3 new machines. Tom’s gross investment for the year totaled
A) 1 machine.
B) 2 machines.
C) 3 machines.
D) 6 machines.
Answer: C

51) At the beginning of the year, Tom’s Tubes had a capital stock of 5 tube inflating machines. During the year, Tom scrapped 2 old machines and purchased 3 new machines. Tom’s capital stock at the end of year equals
A) 1 machine.
B) 2 machines.
C) 3 machines.
D) 6 machines.
Answer: D

52) Depreciation is subtracted from gross domestic product to determine directly
A) consumption expenditures plus investment expenditures plus government purchases plus net exports.
B) disposable income.
C) net domestic product.
D) national income.
Answer: C

53) GDP equals net domestic product plus
A) transfer payments and business transfers.
B) depreciation.
C) indirect business taxes and personal taxes.
D) retained earnings.
Answer: B

54) In the nation of Nirvana, depreciation is $22 billion, GDP is $260.4 billion, and national income is $215.2 billion. Net domestic product is
A) smaller than national income.
B) $215.2 billion.
C) $238.4 billion.
D) $445.2 billion.
Answer: C
57) GDP using the expenditure approach equals the sum of personal consumption expenditures plus
A) gross private investment.
B) gross private investment plus government purchases of goods and services.
C) gross private investment plus government purchases of goods and services minus imports of goods and services.
D) gross private investment plus government purchases of goods and services plus net exports of goods and services.
Answer: D

58) The expenditure approach measures GDP by adding
A) compensation of employees, rental income, corporate profits, net interest, and proprietors’ income.
B) compensation of employees, rental income, corporate profits, net interest, proprietors’ income, subsidies paid by the government, indirect taxes paid, and depreciation.
C) compensation of employees, rental income, corporate profits, net interest, proprietors’ income, indirect taxes paid, and depreciation and subtracting subsidies paid by the government.
D) consumption expenditure, gross private domestic investment, net exports of goods and services, and government purchases of goods and services.
Answer: D

59) Which of the following is NOT part of the expenditure approach to measuring GDP?
A) Gross private domestic investment
B) Net exports of goods and services
C) Net interest
D) Personal consumption expenditures
Answer: C

60) To measure GDP using the expenditure approach you must collect data on
A) inflation.
B) exports.
C) wages.
D) saving.
Answer: B

61) Aggregate expenditures include all of the following EXCEPT
A) consumption of food.
B) purchases of intermediate goods.
C) purchases of a piece of capital equipment.
D) purchases of guns by the government.
Answer: B

62) In the expenditure approach to GDP, the largest component is
A) government purchases.
B) personal consumption expenditures.
C) gross private domestic investment.
D) net exports.
Answer: B

63) Let $C$ represent consumption expenditure, $S$ saving, $I$ gross private domestic investment, $G$ government purchases of goods and services, and $NX$ net exports of goods and services. Then GDP equals
A) $C + S + G + NX$.
B) $C + S + G - NX$.
C) $C + I + G + NX$.
D) $C + I + G - NX$.
Answer: C
64) Consumption expenditure is the payment by households for consumption of
   A) goods but not services.
   B) services but not goods.
   C) goods and services.
   D) services and for saving.
   Answer: C

65) The largest component of GDP is
   A) gross private domestic investment.
   B) personal consumption expenditures.
   C) net exports of goods and services.
   D) government purchases of goods and services.
   Answer: B

66) Personal consumption expenditures include
   A) expenditures by households on goods and services produced only in the United States.
   B) expenditures by households on goods and services produced in the United States and the rest of the world.
   C) the purchase of new homes.
   D) the purchase of used goods and new goods.
   Answer: B

67) All of the following household expenditures are included in consumption expenditure EXCEPT
   A) payment to a dentist for filling a tooth.
   B) purchase of corporate stock.
   C) purchase of a new purse.
   D) purchase of hair styling.
   Answer: B

68) Gross private domestic investment is all purchases of newly produced business capital goods and buildings
   A) minus the change in business inventories.
   B) plus the change in business inventories plus residential construction.
   C) plus fixed investment minus inventory investment.
   D) plus purchases of capital goods produced in previous years to replace any depreciated capital goods.
   Answer: B

69) The difference between gross investment and net investment is
   A) inflation.
   B) depreciation.
   C) initial capital.
   D) consumption.
   Answer: B

70) Goods that are produced this year, stored in inventories, and then sold to consumers next year
   A) count in this year’s GDP.
   B) count in next year’s GDP.
   C) count in both this year’s and next year’s GDP.
   D) are not counted as a part of GDP.
   Answer: A

71) An example of “investment” in computing real GDP using the expenditure approach is the purchase of
   A) a new set of tools by an auto mechanic, for use in repairing cars.
   B) 100 shares of IBM stock.
   C) a 100 year old house by a married couple.
   D) computer chips by IBM to put in their personal computers.
   Answer: A
CHAPTER 5

Topic: Expenditure Approach, Investment
Skill: Conceptual
72) An example of “investment” in the national income accounts is the purchase of
A) a new van by a potter, who packs it with his wares and travels to art shows.
B) 100 shares of Canadian stock on the New York Stock Exchange.
C) a 100-year-old house that was just put on the protected historic sites list in the year in question.
D) a U.S. government bond.

Answer: A

Topic: Expenditure Approach, Investment
Skill: Conceptual
73) In the national income accounts, the purchase of a new house counts as
A) consumption expenditure.
B) investment.
C) a transfer.
D) an addition to inventory.

Answer: B

Topic: Expenditure Approach, Investment
Skill: Conceptual
74) All of the following are included in gross private domestic investment expenditure EXCEPT a
A) business’s purchase of a fleet of cars.
B) household’s purchase of a new house.
C) business’s purchase of another company’s stock.
D) a retail store’s purchase of shoes to add to its inventory.

Answer: C

Topic: Expenditure Approach, Government Purchases
Skill: Recognition
76) In the national income accounts, government purchases of goods and services exclude
A) transfer payments.
B) state and local government purchases.
C) local government purchases but include state government purchases.
D) spending on national defense.

Answer: A

Topic: The Expenditure Approach, Government Purchases
Skill: Recognition
77) Which of the following is included in the government purchases component of the expenditure approach to GDP?
A) State government expenditure on local schools
B) Transfer payments
C) Changes in inventories
D) Taxes

Answer: A

Topic: The Expenditure Approach, Government Purchases
Skill: Recognition
78) Which one of the following transactions in a particular year is included in gross domestic product for that year?
A) Social Security payments to retirees
B) The government pays a computer services company that assisted in the delivery of Social Security payments to retirees
C) A car is produced in the previous year and remains in inventory for the entire year under consideration
D) A stay-at-home parent performs housework that the family would otherwise have paid a maid $20,000 a year to perform.

Answer: B
79) In the computation of GDP, social security payments count as
A) transfer payments and are included in GDP.
B) transfer payments and are not included in GDP.
C) government purchases of goods and services and are included in GDP.
D) government purchases of goods and services and are not included in GDP.
Answer: B

80) Which of the following is NOT part of GDP?
A) General Motors’ purchases of new capital equipment
B) Expenditures by the federal government for national defense
C) Social security payments made to the elderly
D) The purchase of new homes by consumers
Answer: C

81) Transfer payments are not part of government purchases of goods and services because transfer payments
A) are not predictable given the nature of their appropriation and allocation.
B) do not represent the purchase of a final good or service.
C) are not always spent on goods produced in the U.S.
D) The premise of the question is incorrect because transfer payments are part of government purchases of goods and services.
Answer: B

82) Net exports of goods and services equal the
A) exports of goods and services divided by the imports of goods and services.
B) exports of goods and services plus the imports of goods and services.
C) exports of goods and services minus the imports of goods and services.
D) imports of goods and services minus the exports of goods and services.
Answer: C

83) In the calculation of GDP by the expenditure approach, exports from the United States must be
A) subtracted because they are included in the consumption of a foreign country.
B) ignored because they are not bought by U.S. citizens.
C) subtracted if they are bought by foreign firms for investment purposes.
D) added.
Answer: D

84) From the data in the above table, GDP equals
A) $1,120.
B) $1,280.
C) $1,290.
D) $1,360.
Answer: D
85) Using the data in the above table, net domestic product equals
A) $1,120.
B) $1,280.
C) $1,290.
D) $1,360.
Answer: A

86) The approach to GDP that sums compensation of employees, rental income, corporate profits, net interest, proprietors’ income, depreciation, and indirect taxes and subtracts subsidies is the
A) opportunity cost approach.
B) expenditure approach.
C) added cost approach.
D) income approach.
Answer: D

87) The income approach to measuring GDP sums together
A) compensation of employees, rental income, corporate profits, net interest, proprietors’ income, subsidies paid by the government, indirect taxes paid, and capital consumption expenditures.
B) compensation of employees, rental income, corporate profits, net interest, proprietors’ income, indirect taxes paid, and capital consumption expenditures and subtracts subsidies paid by the government.
C) the sales of each firm in the economy.
D) the costs of each firm in the economy and then subtracts indirect business taxes and the capital consumption allowance.
Answer: B

88) Proprietors’ income is a component of which approach to measuring GDP?
A) Incomes approach.
B) Expenditure approach.
C) Cost approach.
D) Output approach.
Answer: A

89) Which of the following is a component of the incomes approach to GDP?
A) Consumption expenditure.
B) Wages and salaries.
C) Investment.
D) Government purchases of goods and services.
Answer: B

90) The largest component of national income is
A) compensation of employees.
B) rental income.
C) corporate profits.
D) proprietors’ income.
Answer: A

91) Which of the following is included in “compensation of employees” part of the income approach to measuring GDP?
I. Wages and salaries.
II. Pension fund contributions.
III. Social security contributions.
A) I only.
B) I and II.
C) I and III.
D) I, II and III.
Answer: D

92) When calculating the compensation of employees part of GDP,
A) social security contributions must be included.
B) fringe benefits are not included.
C) taxes withheld on earnings are not included.
D) the value of vacation time must be included.
Answer: A
**Topic: Income Approach, Net Interest**
**Skill: Recognition**
93) In the national income accounts, net interest is the total interest payments received by households on loans made by them minus
A) interest received from households’ ownership of government bonds.
B) interest payments made by households on their own borrowing.
C) interest payments made by households to foreign lenders.
D) taxes paid by households on their interest income.
**Answer: B**

**Topic: Income Approach, Rental Income**
**Skill: Recognition**
94) Rental income includes
A) the payment for the use of land.
B) the payment for the use of all rented inputs.
C) no income from rental housing because most houses are occupied by their owners.
D) Both answers A and B are correct.
**Answer: D**

**Topic: Income Approach, Corporate Profits**
**Skill: Recognition**
95) Which of the following are included in the category of corporate profits when measuring GDP?
I. Profits paid as dividends.
II. Undistributed profits.
III. Income received by owners and operators of businesses.
A) I only.
B) I and II.
C) I and III.
D) I, II and III.
**Answer: B**

**Topic: Indirect Tax**
**Skill: Recognition**
96) An indirect tax is a tax paid by consumers
A) to a state or local government.
B) when they purchase goods and services.
C) on unearned income (as opposed to wages and salaries).
D) that is a percentage of the value of their real property.
**Answer: B**

**Topic: Indirect Tax**
**Skill: Conceptual**
97) All of the following are indirect taxes EXCEPT
A) cigarette sales taxes.
B) income taxes.
C) liquor excise taxes.
D) taxes on utility bills.
**Answer: B**

**Topic: Net Domestic Income At Factor Cost**
**Skill: Recognition**
98) The sum of compensation to employees, rental income, corporate profits, net interest, and proprietors’ income is
A) gross domestic product.
B) gross domestic income.
C) net domestic income at factor cost.
D) net domestic product.
**Answer: C**

**Topic: Income Approach**
**Skill: Conceptual**
99) Reasons why valuing goods at their market prices is different than valuing them at their factor costs include
A) depreciation and investment.
B) exports and imports.
C) personal taxes and corporate taxes.
D) indirect taxes and subsidies.
**Answer: D**

**Topic: Income Approach, Depreciation**
**Skill: Recognition**
100) Gross domestic product minus net domestic product equals
A) exports minus imports.
B) imports minus exports.
C) net taxes.
D) depreciation.
**Answer: D**
### Topic: Income Approach

**Skill: Analytical**

101) Using the data in the table above, gross domestic product equals

A) $1,920.
B) $1,940.
C) $2,150.
D) $2,400.

**Answer: D**

### Topic: Expenditure Approach

**Skill: Analytical**

102) Using the data in the above table, gross private domestic investment equals

A) $250.
B) $260.
C) $460.
D) some amount that cannot be determined without more information.

**Answer: C**

### Topic: Expenditure Approach

**Skill: Analytical**

103) Using the data in the above table, net private domestic investment equals

A) $210.
B) $260.
C) $510.
D) some amount that cannot be determined without more information.

**Answer: A**

### Real GDP and the Price Level

**Topic: Real GDP**

**Skill: Recognition**

106) Real GDP measures the

A) total profits earned by all businesses valued using prices from a single year.
B) changes in the prices of output measured in dollars.
C) general upward drift in prices.
D) value of total production linked to prices of a single year.

**Answer: D**

---

<table>
<thead>
<tr>
<th>Component</th>
<th>Amount (billions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross investment</td>
<td>1300</td>
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<tr>
<td>Personal consumption expenditure</td>
<td>1475</td>
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<tr>
<td>Depreciation</td>
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<tr>
<td>Government purchases</td>
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<td>U.S. imports</td>
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<tr>
<td>U.S. exports</td>
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<tr>
<td>Compensation of employees</td>
<td>65</td>
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<td>Personal consumption expenditures</td>
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<tr>
<td>Government purchases of goods</td>
<td></td>
</tr>
<tr>
<td>and services</td>
<td></td>
</tr>
<tr>
<td>Net exports of goods and services</td>
<td></td>
</tr>
</tbody>
</table>
107) The old, traditional base-year method of calculating real GDP compared
A) the quantities of goods produced in consecutive years using prices in both years and averaging the percentage changes in the value of output.
B) quantities produced in different years using prices from a year chosen as a reference period.
C) quantities produced in different years with the prices that prevailed during the year in which the output was produced.
D) prices at different points in time using a sample of goods that is representative of goods purchased by households.

Answer: B

108) Which of the following relationships is correct?
A) Nominal GDP = (GDP Deflator ÷ Real GDP) × 100
B) Real GDP = (Nominal GDP × GDP Deflator) ÷ 100
C) GDP Deflator = (Nominal GDP ÷ Real GDP) × 100
D) Real GDP = Nominal GDP × 100

Answer: C

109) To calculate real GDP, the GDP deflator can be used to adjust nominal GDP for changes in
A) national income.
B) the unemployment rate.
C) the cost of the typical urban worker’s market basket.
D) the general price level.

Answer: D

110) Economists distinguish real from nominal GDP to
A) determine whether the government sector is growing.
B) measure the change in nominal interest rates.
C) determine whether economic welfare has changed.
D) determine whether real production has changed.

Answer: D

111) In years with inflation, nominal GDP increases ______ real GDP.
A) faster than
B) slower than
C) at the same rate as
D) sometimes faster, sometimes slower, and sometimes at the same rate as

Answer: A

112) Suppose an economy has some inflation. Then, after a base year, the value of real GDP will
A) be less than nominal GDP.
B) not be different from nominal GDP.
C) be greater than nominal GDP.
D) will be approximately half the value of nominal GDP.

Answer: C

113) If nominal GDP is $5 trillion and the GDP deflator is 125, what is real GDP?
A) $4 trillion
B) $0.04 trillion
C) $625 trillion
D) $6.25 trillion

Answer: A

114) What is the value of real GDP if the value of the GDP deflator is 122.5 and nominal GDP is $825 billion?
A) $6.735 billion
B) $673.5 billion
C) $702.5 billion
D) $1,010.6 billion

Answer: B
115) The chain-weighted output index
A) uses only the current year’s prices to calculate growth in real GDP.
B) uses prices for the current year and the previous year to calculate growth in real GDP.
C) must only be calculated every other year.
D) is an inaccurate way to measure growth in real GDP and so has been replaced by the “nominal-to-real” index.

Answer: B

116) The chain-weighted output index method of calculating real GDP compares
A) compares the quantities of goods produced in consecutive years using prices in both years and averaging the percentage changes in the value of output.
B) quantities produced in different years using prices from a year chosen as a reference period.
C) quantities produced in different years with the prices that prevailed during the year in which the output was produced.
D) prices at different points in time using a sample of goods that is representative of goods purchased by households.

Answer: A

117) The chain-weighted output index method of measuring real GDP is based on
A) using current prices rather than base year prices
B) averaging the market value of the expenditures over a two year period and then comparing with a base period.
C) using the prices of two adjacent years to calculate the growth rate of real GDP.
D) averaging the nominal and real measures of GDP to come up with a more accurate figure.

Answer: C

118) The GDP deflator equals 100 times
A) nominal GDP divided by real GDP.
B) real GDP divided by nominal GDP.
C) gross domestic product divided by net domestic product.
D) net domestic product divided by gross domestic product.

Answer: A

119) Suppose that nominal GDP per person is $18,000 in 2004, the 1998 GDP deflator is 100, and the 2004 GDP deflator is 110. The approximate real per person GDP in 2004 is
A) $16,364.
B) $16,634.
C) $18,000.
D) $19,800.

Answer: A

120) Suppose that nominal GDP per person is $17,000 in 2004, the 1998 GDP deflator is 100, and the 2004 GDP deflator is 90. The approximate real GDP per person in 2004 is
A) $17,000.
B) $18,889.
C) $32,300.
D) $15,300.

Answer: B

121) Suppose that nominal GDP per person is $21,000 in 2004, the 1998 GDP deflator is 100, and the 2004 deflator is 105. The approximate real GDP per person in 2004 is
A) $20,000.
B) $21,000.
C) $19,048.
D) $22,050.

Answer: A
Topic: GDP Deflator
Skill: Recognition
122) The implicit GDP deflator is calculated by
A) comparing the quantities of goods produced in consecutive years using prices in both years and averaging the percentage changes in the value of output.
B) comparing the quantities produced in different years using prices from a year chosen as a reference period.
C) comparing the quantities produced in different years with the prices that prevailed during the year in which the output was produced.
D) dividing nominal GDP by real GDP.
Answer: D

Measuring Economic Growth

Topic: Over Adjustment for Inflation
Skill: Conceptual
123) If the GDP deflator is biased by quality changes, the result is that
A) nominal GDP is understated.
B) real GDP is overstated.
C) there is no effect upon the correct level of real GDP.
D) real GDP is understated.
Answer: D

Topic: Household Production
Skill: Recognition
124) Which of the following is NOT included in real GDP?
A) Production of services, such as the services of doctors.
B) Production of goods that last more than one year, such as television sets.
C) Production of goods that do not last more than one year, such as gasoline.
D) Production in the home.
Answer: D

Topic: Household Production
Skill: Analytical
125) If a larger fraction of the adult population is working, household production
A) counted in real GDP increases.
B) not counted in real GDP increases.
C) counted in real GDP decreases.
D) not counted in real GDP decreases.
Answer: D

Topic: Underground Economic Activity
Skill: Recognition
126) Which of the following is NOT included in real GDP?
A) Production of services, such as the services of hairdressers.
B) Production of goods that last less than a year, such as production of hot dogs.
C) Production of goods that last more than a year, such as a pair of roller blades.
D) Production that takes place in the underground economy.
Answer: D

Topic: Underground Economic Activity
Skill: Conceptual
127) The underground economy exists for all of the following reasons EXCEPT the
A) production of illegal goods.
B) avoidance of taxes.
C) desire to maintain accurate records of economic transactions.
D) avoidance of government regulation.
Answer: C

Topic: Environmental Quality
Skill: Conceptual
128) Because pollution reduces economic welfare, real GDP
A) decreases as pollution increases.
B) increases to take into account the expenditures that will be made in the future to clean up the pollution.
C) overstates economic welfare.
D) understates economic welfare.
Answer: C
CHAPTER 5

Topic: Environmental Quality
Skill: Conceptual
129) In the post World War II period, considerable growth in total production took place in the U.S. But at the same time, businesses were able to produce by dumping their waste into the Great Lakes with minimal cost, significantly polluting the bodies of water as a result. This occurrence is an example where
A) real GDP gives an overly positive view of economic welfare.
B) real GDP gives an overly negative view of economic welfare.
C) investment would have been a better measure of total production.
D) the pollution counts as a final good.
Answer: A

Topic: Environmental Quality
Skill: Conceptual
130) Which of the following would lead GDP to overstate economic welfare?
A) the existence of home-cooked meals.
B) restaurant workers that under-report tip income.
C) a self-employed CPA who takes a longer than normal vacation.
D) electric utilities that switch to burning coal because of higher natural gas prices and thereby create more acid rain pollution.
Answer: D

Topic: Purchasing Power Parity Prices
Skill: Recognition*
132) If we compare the U.S. GDP and the Chinese GDP, 
A) GDP per person is about the same in the two countries.
B) U.S. GDP per person is less than China’s GDP per person once we adjust for currency differences.
C) China’s GDP per person is less than GDP per person in the United States.
D) U.S. GDP per person was much larger than China’s GDP per person when purchasing power parity prices are used but is less than China’s GDP per person when exchange rate prices are used.
Answer: C

Study Guide Questions

Topic: Study Guide Question, GDP
Skill: Conceptual
133) Which of the following is NOT a final good?
A) a new computer sold to an NYU student
B) a new car sold to Avis for use in their fleet of rental cars
C) a purse sold to a foreign visitor
D) a hot dog sold to a spectator at a Chicago Bears football game
Answer: B

Topic: Study Guide Question, Expenditure Equals Income
Skill: Conceptual
134) GDP equals
A) aggregate expenditure.
B) aggregate income.
C) the value of the aggregate production in a country during a given time period.
D) all of the above.
Answer: D
Topic: Study Guide Question, Financing Investment
Skill: Recognition
135) A nation’s investment must be financed by
A) national saving only.
B) the government’s budget deficit.
C) borrowing from the rest of the world only.
D) national saving plus borrowing from the rest of the world.
Answer: D

Topic: Study Guide Question, Flows and Stocks
Skill: Conceptual
136) Which of the following is a flow?
A) GDP
B) Wealth
C) The amount of money in a savings account
D) Capital
Answer: A

Topic: Study Guide Question, Flows and Stocks
Skill: Conceptual
137) Which of the following is a stock?
A) Income
B) Depreciation
C) Investment
D) Capital
Answer: D

Topic: Study Guide Question, Flows and Stocks
Skill: Conceptual
138) ____ is a flow variable and ____ is a stock variable.
A) Wealth; income
B) Income; capital
C) Wealth; capital
D) Depreciation; income
Answer: B

Topic: Study Guide Question, Expenditure Approach, Investment
Skill: Conceptual
139) Gross private domestic investment is a component of which approach to measuring GDP?
A) Incomes approach
B) Expenditure approach
C) Linking approach
D) Output approach
Answer: B

Topic: Study Guide Question, Incomes Approach
Skill: Conceptual
140) Which of the following is NOT a component of the incomes approach to GDP?
A) Net exports
B) Wages and salaries
C) Corporate profits
D) Proprietors’ income
Answer: A

Topic: Study Guide Question, Real GDP
Skill: Recognition
141) Currently, real GDP is calculated using
A) the quantities only method.
B) base year prices method.
C) current year prices method.
D) chain-weighted output index method.
Answer: D

Topic: Study Guide Question, Real and Nominal GDP
Skill: Analytical
A) $104
B) $106
C) $108
D) None of the above answers is correct.
Answer: B

Topic: Study Guide Question, Real and Nominal GDP
Skill: Analytical
143) If the GDP deflator for 2004 is 125, nominal GDP
A) equals real GDP in 2004.
B) is greater than real GDP in 2004.
C) is less than real GDP in 2004.
D) in 2003 will be less than real GDP in 2004.
Answer: B
### Year Nominal GDP (billions of dollars) Real GDP (billions of dollars) GDP deflator

<table>
<thead>
<tr>
<th>Year</th>
<th>Nominal GDP</th>
<th>Real GDP</th>
<th>GDP deflator</th>
</tr>
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<tbody>
<tr>
<td>2004</td>
<td>2500</td>
<td>___</td>
<td>105</td>
</tr>
<tr>
<td>2005</td>
<td>___</td>
<td>2400</td>
<td>117</td>
</tr>
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</table>

**Topic:** Study Guide Question, Real and Nominal GDP  
**Skill:** Analytical

144) Using the data in the above table, what is real GDP in 2004?  
A) $2137 billion.  
B) $2520 billion.  
C) $2381 billion.  
D) $2051 billion.  
**Answer:** C

145) Using the data in the above table, what is nominal GDP in 2005?  
A) $2400 billion.  
B) $2381 billion.  
C) $2808 billion.  
D) $2520 billion.  
**Answer:** C

**Topic:** Study Guide Question, Environmental Quality  
**Skill:** Conceptual

146) Pollution is a by-product of some production processes, so real GDP as measured  
A) is adjusted downward to take into account the pollution.  
B) is adjusted upward to take into account the expenditures that will be made in the future to clean up the pollution.  
C) tends to overstate economic welfare.  
D) tends to understate economic welfare.  
**Answer:** C

**MyEconLab Questions**

**Topic:** Flows and Stocks  
**Level 1: Definitions and Concepts**

149) An example of a stock is ___ and an example of a flow is ___.  
A) depreciation; capital  
B) capital; investment  
C) investment; capital  
D) investment; depreciation  
**Answer:** C
Topic: Capital and Investment
Level 1: Definitions and Concepts
150) Depreciation equals ____.
   A) capital minus gross investment
   B) capital minus net investment
   C) net investment minus gross investment
   D) gross investment minus net investment
Answer: D

Topic: Expenditure Approach, Government Purchases
Level 1: Definitions and Concepts
151) Government purchases include ____.
   A) social security and education
   B) net exports
   C) buying a new bomber
   D) Both answers A and C are correct
Answer: C

Topic: Financing Investment
Level 1: Definitions and Concepts
152) A country’s investment can be financed by ____.
   A) a government budget surplus
   B) national saving and foreign borrowing
   C) only saving by households and firms
   D) making exports exceed imports
Answer: B

Topic: Expenditure Approach
Level 1: Definitions and Concepts
153) Gross Domestic Product is equal to the sum of consumption expenditure, investment, net exports, and ____.
   A) government purchases
   B) saving
   C) profits
   D) net taxes
Answer: A

Topic: Intermediate Goods and Services
Level 1: Definitions and Concepts
154) Intermediate goods and services ____.
   A) are double counted in GDP
   B) are used to produce final goods and services
   C) include used goods
   D) are included in GDP
Answer: B

Topic: Income Approach
Level 1: Definitions and Concepts
155) The income approach measures GDP by adding together compensation of employees, proprietors’ income, ____.
   A) net investment, saving, and farmers’ income
   B) net interest, rental income, and corporate profits
   C) net investment, rental income, and corporate profits
   D) net saving, investment income, and profits
Answer: B

Topic: Chain-Weighted Growth Rate
Level 1: Definitions and Concepts
156) The chain-weighted output index method ____.
   A) is used to calculate the value of nominal GDP
   B) values the quantities produced in a year at the prices of the base year
   C) shows that real GDP increases every year
   D) uses the prices of two adjacent years to calculate the real GDP growth rate
Answer: D

Topic: GDP Deflator
Level 1: Definitions and Concepts
157) The measure of the price level, which is an average of current year prices expressed as a percentage of base-year prices is the ____.
   A) GDP inflator
   B) inflation rate
   C) Urban GDP Price Level
   D) GDP deflator
Answer: D

Topic: GDP Deflator
Level 1: Definitions and Concepts
158) GDP deflator equals ____.
   A) \((\text{Nominal GDP} ÷ 100) \times \text{Real GDP}\)
   B) \((\text{Nominal GDP} ÷ \text{Real GDP}) \times 100\)
   C) nominal GDP
   D) \((\text{Real GDP} ÷ \text{Nominal GDP}) \times 100\)
Answer: B
159) Investment is a ____ that ____ the ____ of capital.
A) flow; increases; stock
B) stock; decreases; stock
C) stock; increases; flow
D) flow; adds to; flow
Answer: A

160) When ____ is greater than ____, saving increases ____.
A) income; government purchases; wealth
B) income; consumption expenditure; wealth
C) consumption expenditure; government purchases; wealth
D) government purchases; consumption expenditure; taxes
Answer: B

161) If the government budget is balanced and investment is equal to saving, then ____.
A) exports equal imports
B) net exports are positive
C) the country does not trade internationally
D) net exports are negative
Answer: A

162) Which of the following items is not a component of the expenditure approach to measuring U.S. GDP?
A) purchases of food made by families
B) social security payments made by the government
C) purchases of U.S.-made movies by Europeans
D) purchases of new homes made by families
Answer: A

163) Which of the following items is not a component of the income approach to measuring U.S. GDP?
A) interest earned on savings deposits
B) profits made by businesses
C) income earned by businesses that export goods
D) investment
Answer: D

164) Which of the following items are counted in GDP? A taxi company’s ____.
A) sale of some bonds to finance its purchases
B) purchase of new trip meters for its cabs
C) sale of 5 old cabs
D) purchase of 5 new cabs
Answer: D

165) Paying higher prices means that our ____.
A) standing of living has decreased
B) cost of living has increased
C) cost of living has increased and our standard of living has increased
D) standard of living has increased
Answer: B

166) One year after the base year, the price level rises. In this year, nominal GDP is ____ real GDP, and the GDP deflator is ____.
A) less than; less than 100
B) equal to; equal to 10
C) greater than; greater than 100
D) less than; greater than 100
Answer: C

167) What we produce during our working time is ____ as part of GDP and the enjoyment we gain from our leisure time is ____ as part of GDP.
A) included; not included
B) included; included
C) not included; included
D) not included; not included
Answer: A
**Topic: GDP and Economic Welfare Comparisons**

Level 2: Using Definitions and Concepts

168) Real GDP is not a good indicator of economic welfare because ____.

A) it includes the underground economy
B) it includes a direct measure of health and life expectancy
C) it underestimates inflation
D) economic welfare depends on many factors not measured or not measured accurately by real GDP

Answer: D

**Item** | **Millions of dollars**
---|---
Personal consumption expenditure | 80
Government purchases of goods and services | 30
Net taxes | 35
Gross private domestic investment | 20
Imports of goods and services | 10
Exports of goods and services | 20

**Topic: Expenditure Approach**

Level 3: Calculations and Predictions

169) Using the information in the table above, calculate the value of GDP.

A) $185 million
B) $145 million
C) $195 million
D) $140 million

Answer: D

**Topic: Financing Investment**

Level 3: Calculations and Predictions

171) Use the information in the table above to calculate the value of private saving.

A) −$15 million
B) $40 million
C) $25 million
D) $20 million

Answer: C

**Topic: Financing Investment**

Level 3: Calculations and Predictions

172) Use the information in the table above to calculate the value of government saving.

A) $15 million
B) −$5 million
C) $5 million
D) $45 million

Answer: C

<table>
<thead>
<tr>
<th><strong>Item</strong></th>
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<td>Net interest and rental income</td>
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<td>Corporate profits</td>
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</tr>
<tr>
<td>Proprietor’s income</td>
<td>20</td>
</tr>
</tbody>
</table>

**Topic: Net Domestic Income at Factor Cost**

Level 3: Calculations and Predictions

173) Use the information in the table above to calculate the value of net domestic income at factor cost.

A) $80 billion
B) $140 billion
C) $100 billion
D) $90 billion

Answer: B

**Topic: Income Approach**

Level 3: Calculations and Predictions

174) Use the information in the table above plus the fact that indirect taxes less subsidies are $10 billion and depreciation is $30 billion to calculate the value of GDP.

A) $180 billion
B) $150 billion
C) $140 billion
D) $130 billion

Answer: A
<table>
<thead>
<tr>
<th>Year</th>
<th>Nominal GDP (billions of dollars)</th>
<th>Real GDP (billions of 2000 dollars)</th>
<th>GDP deflator</th>
</tr>
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<tbody>
<tr>
<td>2003</td>
<td>90</td>
<td>120</td>
<td>125</td>
</tr>
<tr>
<td>2004</td>
<td>125</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Topic: Real and Nominal GDP**

*Level 3: Calculations and Predictions*

175) Use the information in the table above to calculate nominal GDP in 2003.

A) $75 billion  
B) $0.75 billion  
C) $10,800 billion  
D) $108 billion  

**Answer: D**

176) Use the information in the table above to calculate real GDP in 2004.

A) $1 billion  
B) $100 billion  
C) $156.25 billion  
D) $95 billion  

**Answer: B**

**Topic: GDP Growth Rate**

*Level 3: Calculations and Predictions*

177) If real GDP in 2003 is $9 trillion and real GDP in 2004 is $9.27 trillion, then the economic growth rate in 2004 is ____.

A) 2.7 percent  
B) $0.27 trillion  
C) 3.0 percent  
D) $9.27 trillion  

**Answer: C**

178) At 2003 prices, the value of production in 2004 was 6 percentage points higher than in 2003. At 2004 prices, the value of production in 2004 was 4 percentage points higher than in 2003. Using the chain-weighted output index, real GDP is ____ in 2004 than in 2003.

A) 10 percent greater  
B) 5 percent greater  
C) 7.5 percent greater  
D) 4 percent smaller  

**Answer: B**

**Topic: Expenditure Approach**

*Level 4: Advanced Calculations and Predictions*

179) In 2004, the country of Nerf had its imports equal its exports. Nerf’s GDP was $500 million, its consumer expenditure was $380 million, and its investment was $20 million. Nerf’s government purchases were ____.

A) $100 million  
B) $900 million  
C) $500 million  
D) zero  

**Answer: A**

**Topic: Financing Investment**

*Level 4: Advanced Calculations and Predictions*

180) Last year in the country of More, government purchases of goods and services were $20 million and the government had a budget deficit of $3 million. Consumption expenditure was $7 million, and there was dissaving of $2 million. GDP in More was ____.

A) $28 million  
B) $32 million  
C) $22 million  
D) $26 million  

**Answer: C**

181) The country of Erdf has net exports of $5 million. Government purchases of goods and services are $15 million and the government has a budget surplus of $5 million. Investment is $5 million. Private saving in Erdf is ____.

A) $10 million  
B) zero  
C) $15 million  
D) $5 million  

**Answer: D**
182) The country of Erdf has net exports of $-5 million. Government purchases of goods and services are $15 million and the government has a budget surplus of $5 million. Investment is $5 million. National saving in Erdf is ____.

A) $10 million  
B) $15 million  
C) $5 million  
D) $-5 million 

Answer: A

183) If the government has a budget surplus and saving is equal to investment, then ____.

A) aggregate expenditure does not equal aggregate income  
B) imports exceed exports  
C) imports equal exports  
D) imports are less than exports 

Answer: D

184) In the country of Darrowby, net domestic income at factor cost is $2.0 million. Gross domestic product is $3.0 million, and depreciation is $0.5 million. Indirect taxes less subsidies ____.

A) are $1 million  
B) are $0.5 million  
C) cannot be calculated  
D) are $-0.5 million 

Answer: B

185) Real GDP fluctuations tend to ____ fluctuations in total production because household production ____.

A) overstate; increases during a recession and decreases during an expansion  
B) overstate; decreases during a recession and increases during an expansion  
C) underestimate; decreases during a recession and increases during an expansion  
D) underestimate; increases during a recession and decreases during an expansion 

Answer: A


A) $10.5  
B) $11  
C) $10.1  
D) $12.72 

Answer: A

187) Choose the best statement.

A) GDP equals aggregate expenditure and equals aggregate income.  
B) An increase in government purchases increases aggregate expenditure but does not change GDP.  
C) An increase in compensation of employees increases aggregate income but does not change GDP.  
D) GDP always equals aggregate expenditure and sometimes equals aggregate income. 

Answer: A

188) In the country of Kemper, real GDP in 2003 was $5 billion and real GDP in 2004 was $5.5 billion. The economic growth rate in 2004 was ____ .

A) 16.7 percent a year  
B) $0.5 billion  
C) 10 percent a year  
D) 1 percent a year 

Answer: C