PART I: INTRODUCTION AND MEASUREMENT
CHAPTER 1: INTRODUCTION

ADDITIONAL QUESTIONS

Chapter 1 is intended primarily to introduce the student to the subject matter of the book. Multiple-choice questions do not seem appropriate to this chapter. Additional essay questions are:

1. Explain the difference between Microeconomics and Macroeconomics.

Microeconomics and macroeconomics differ in the economic unit on which they focus. Microeconomics focuses on the individual economic agent, i.e., the consumer or the firm. Whereas macroeconomics considers the economy as a whole. There is a close link between the two branches, however, because many macroeconomic relationships are based on aggregate versions of the behavioral relationships derived on the microeconomic level.

2. In general terms describe trends in the inflation rate, considering the period since 1953. How are these trends related to movements in the inflation rate over this period?

   Trend inflation rose steadily in the 1950s and 1960s, then rose dramatically during the 1970s. Beginning in the early 1980s, inflation fell precipitously until 1987, then has remained relatively constant around 2% since.

3. Briefly discuss three macroeconomic issues that have been in the news recently. Find articles from newspapers or the internet that discuss these issues.

   Answers will vary.

4. What is meant by *real* Gross Domestic Product? How do you think that you calculate a real statistic?

   Real Gross Domestic product measures total output in the U.S. adjusted for changes in the price level. The easiest way to calculate a real statistic is to use a constant set of prices across every year.

5. We measure economic growth by the percentage change in real GDP. In general terms outline the course of the U.S. output growth rate in recent decades, both in terms of its trend and its changes around trend. Pay particular attention to the stability of the growth rate.

   Real output growth has been highly volatile around a trend of roughly 3% a year. It was relatively steady during the 1960s and consistently positive. During the 1970s and early 1980s there were numerous periods of negative growth. Since 1983, growth has been positive and relatively stable except for brief periods in 1990-1991 and 2001.

6. In general terms describe how the federal budget deficit has changed since the early 1950s. How has the U.S. trade balance changed since the 1950s? Does it appear that there is any correlation between the two?

   Both the trade and budget balance were in roughly zero until the 1980s when the budget deficit increased dramatically and the U.S. trade deficit increased dramatically. However, during the late 1990s the budget deficit shrank—in fact, moving to surplus—at the same time that the U.S. trade deficit increased significantly.

7. What is the relationship between a country's trade balance and its stance as a borrower or lender? Historically, has the U.S. been a net lender or net borrower? Why do you think that this is? Do you think that the U.S. budget situation might have anything to do with this?

   Countries that run trade deficits must borrow from other countries to pay for this. Thus, countries that run trade deficits are net borrowers. The huge budget deficits in the U.S. coupled with its high levels of consumption (and low savings) have led it to becoming the largest debtor nation in the world. Large trade deficits have occurred during the same time that the U.S. has also been running large budget deficits, indicating that there may well be some cause and effect between the two.

8. What are the four primary questions in macroeconomics? Which focus on short-run issues? Which focus on long-run issues?

   The four questions are:

   1. What determines the *cyclical* behavior of output and employment? What causes recessions?

   2. What are the determinants of the rate of inflation? What role do macroeconomic policies play in determining inflation?

   3. What relationship exists between inflation and unemployment? Why were both the unemployment rate and the inflation rate so high during much of the 1970s? What became of the negative relationship that existed between these two variables in the 1950s and 1960s (see Figure 1-5a)?

   4. What determines the rate of growth in output over periods of one or two decades? Over longer periods such as a century?

Questions 1 and 3 are primarily short-run issues, 2 and 4 are long-run issues.