Quiz for Chapter 4 (FAQ’s)

4) In the circular flow of income
   A) households demand goods and services that are supplied by firms, while supplying factors that are demanded by firms.
   B) households sell goods and services while firms sell factors.
   C) households demand goods and services that are supplied by firms, and the firms demand factors that are supplied by intermediate firms.
   D) households buy goods and services while firms sell goods and services. Firms obtain labor from households, capital from government, and raw materials from other firms.

Answer: A. In good and services markets, households are consumers while firms are producers. Therefore, households demand goods and services that are produced and supplied by firms. In factor markets, firms are consumers of inputs needed in production while households are assumed to own those inputs. Therefore, households supply factors that are demanded by firms. (p.109 textbook)

7) If the United States spends ________ on foreign goods and services than foreigners spend on U.S.-made goods and services, the United States ________
   A) less; must save more
   B) less; borrows from the rest of the world
   C) more; lends to the rest of the world
   D) more; borrows from the rest of the world

Answer: D. Exports are goods and services sold to the rest of the world, so they create revenue to the country. Imports are goods and services bought from the rest of the world, so they are expenditures that the country incurs. “The US spending more on foreign goods and services than foreigners spending on US-made goods and services” implies that imports > exports. So expenditure > revenue and the US borrows from the rest of the world. (p.110 textbook)

11) An economist giving a lecture mentions that positive net investment creates growth in capital equipment, which increases worker productivity. In this statement a flow variable is ________ and a stock variable is ________
   A) capital; net investment
   B) net investment; capital
   C) productivity; net investment
   D) capital; productivity

Answer: B. Flow is a quantity per unit of time while stock is a quantity at a point in time. For example, water from the running faucet is a flow while water in a bathtub is a stock. Similarly, when we talk about amount of capital, we say capital at the end of the year, capital at the beginning of the year, etc. So capital is a stock. However, when we talk about investment, we say investment per quarter, investment per year, etc. So investment is a flow. (p.111 textbook)
16) Which of the following purchases is included in personal consumption expenditures when determining gross domestic product?

A) vacation expenses for a spring trip to Fort Lauderdale
B) purchases of jeans to add to a store’s inventory
C) purchase of a new office building
D) purchase of a new house because of the arrival of a new baby

**Answer:** A. Personal consumption expenditures are the expenditures by households on final goods and services produced in the US and in the rest of the world. They do not include the purchase of new homes, which is counted as part of investment. But they do include the purchase of consumer durable goods, which technically are capital like homes. With this definition, jeans in B would be considered as intermediate goods, new office building in C investment, and new house in D investment. (p.113 textbook)

18) In the calculation of gross domestic product by the expenditure approach, the “investment” component is

A) gross investment minus depreciation.
B) net investment.
C) gross investment.
D) gross investment plus depreciation.

**Answer:** C. According to expenditure approach, the investment component is gross (private domestic) investment. It is expenditure on capital equipment and buildings by firms and expenditure on new homes by households. It also includes the change in business inventories. (p.113 textbook)

19) Of several purchases made by a family farm, which of the following would be included in GDP as part of investment expenditure?

A) a U.S. government bond.
B) 100 shares of corporate stock.
C) 10 acres of land.
D) a new tractor.

**Answer:** D. By definition, investment is the purchase of new capital. It also includes additions to inventories. And capital is defined as the plant, equipment, buildings, and inventories of raw materials and semifinished goods that are used to produce other goods and services. Therefore, C is not right because we don’t know if it is new land. Note that used capitals and existing home were part of GDP in the year in which they were produced. A and B are also not right because they can’t be used to produce other goods and services, so they are not capital. In fact, financial assets are not part of GDP as they are neither final goods nor intermediate goods. (p.111 textbook)

21) Which of the following transfer payments is included in GDP?

A) welfare payments
B) veteran’s benefits
C) Social Security payments
D) none of the above

**Answer:** D. Transfer payments are not purchases of goods and services, so they are not part of GDP (government purchases of goods and services). Welfare payments, social security payments, and veteran’s benefits do not create new good and services in return at the time that they occur. (p.113 textbook)
31) Based on the data in the above table, gross domestic product equals _______ and net domestic product equals _______.

A) $2,465; $2,265  
B) $2,750; $2,550  
C) $2,550; $2,850  
D) $2,600; $2,850

Answer: A. According to the expenditure approach, GDP is measured as follows:

GDP = personal consumption expenditures + gross private domestic investment +
government purchases of goods and services + net exports of goods and services
+ net exports of goods and services
= 1500 + 355 + 590 + (70-50) = 2465

as for net domestic product, we have the following:

net domestic product = GDP – depreciation = 2465 – 200 = 2265

(p.112 textbook)