

Macroeconomics Discussion Session Exercise #3

1. “I got a 2% raise but my standard of living still went down this year.” Explain thoroughly how this is possible.

Your nominal income went up, but for your standard of living to have gone down your real income must have dropped, which means that inflation must have been higher than your raise, say 3% or more.

2. What are the problems with measuring GDP/GNP.

- a. doesn't account for non-monetized productive activity like volunteer work, do it yourself jobs, unpaid housework and child rearing, barter, helping out a friend fix their car or paint their house, etc.

- b. doesn't account for monetized productive activity that is not reported, like illegal and unreported income, like working under the table, cheating on income taxes, etc.

- c. doesn't account for resource depletion – natural resources are being used up as growth increases, but GDP/GNP doesn't tell us that.

3. Is GDP/GNP a good indicator of society's well-being? Why or why not?

No, GDP/GNP is not a good indicator of society's well-being. First, it says nothing about the distribution of income and output. Per capita income is the same if all income is split evenly or if one person has everything but one penny. And well-being will be affected by distribution. Second, the issue of resource depletion mentioned in #3 above—society may be on an unsustainable growth path based on natural resources that will run out, cutting off the source of growth. Third, there are “costs of life” expenses or “necessary evils” These are things that make GDP/GNP higher but do not necessarily indicate more well-being, like alarms on your house and car, environmental clean-up. Finally, GNP/GDP are purely quantitative, don't show qualitative differences between different kinds of expenditure. So \$5 for food for a hungry child and \$5 for a rich person's bad habit both make GDP/GNP go up by the same amount, yet they affect well-being differently.

4. How is the official unemployment rate calculated? Who is not included in it and what affect does this have on the official rate? How is the marginalization rate calculated?

The BLS (Bureau of Labor Statistics) does a phone survey of 55,800 households. Ask are you employed? If yes, you are employed and in the labor force. If no, they ask have you been “actively seeking work” (ASW) in the last four weeks? ASW means answering a want as, contacting employment agency or the equivalent. If yes, you are counted as in the labor force and as officially unemployed. If no, and you say you do want to work, you are called a “discouraged worker.” The official unemployment rate takes the officially unemployed divided by the labor force (then multiply by 100 to get the percentage). Not included in the official unemployment rate are the following: discouraged workers, women without adequate or affordable child care, people without adequate transportation, long term ill, on strike, involuntary part time workers, homeless, phoneless, natural disaster, those working for family business without pay. Not including these in the official unemployment rate biases the official rate downward (it would be higher if they were included).

The marginalization rate is the officially unemployed, involuntary part time workers, and discouraged workers. The discouraged are also added to the denominator. This rate is usually almost 1.5 times higher than the official unemployment rate and can be double.