

OLLSCOIL NA hÉIREANN, GAILLIMH
NATIONAL UNIVERSITY OF IRELAND, GALWAY

SUMMER 2000

PAPER 1

ECONOMICS
EC100, EC101 AND EC102

1st BA; 1st BComm; 1st BA, Public and Social Policy; 1st BComm w/ French; 1st BComm w/ Spanish; 1st BComm w/ German; ; 1st B. Corp. Law
1st BSc in Financial Mathematics and Economics;

Professor J. Round
Professor Michael Keane
Mr. Matthew Coffey
Mr. Brendan Kennelly

Time Allowed: Three Hours

Directions: There are three sections. Follow the directions for each section and note the marks associated with each. Place the multiple choice answers on the specially designed MCQ answer sheet. Each of the other sections should be answered in a separate answer booklet. Show all of your work. Good luck.

Section A: Multiple Choice (90 marks)

There are thirty (30) multiple choice questions to be answered on the special sheet provided.

Please enter your ID number on the answer sheet. *Enter 0* in the last of the nine boxes. Also on the answer sheet write your name and degree.

Negative marking will be used for the multiple choice questions. For each correct answer you will receive a score of 3.0, a score of 0 if the question is not answered. If the questioned is answered incorrectly, a score of -0.6 will be given. *For each question only one answer will be accepted. If you make a mistake on the answer sheet you must erase or "white-out" the incorrect answer. Merely crossing out the wrong answer will not work.*

1. Which of the following is **not** a component of Aggregate Demand?
 - a. Savings
 - b. Consumption
 - c. Investment
 - d. Government Spending
2. The higher the Marginal Propensity to Consume, the
 - a. higher the Marginal Propensity to Tax
 - b. higher the Marginal Propensity to Save
 - c. lower the Multiplier
 - d. higher the Multiplier
3. The Multiplier in Ireland is
 - a. lower because of the high amount of imports
 - b. higher because of the high amount of exports
 - c. high because of the European Union
 - d. none of the above
4. Which of the following is part of a Expansionary Fiscal Policy:
 - a. an increase in taxes
 - b. an increase in government spending
 - c. an increase in the money supply
 - d. both (a) and (b)
5. Gross domestic product:
 - a. is the market value of all final goods and services produced within a country in a given period (usually a year).
 - b. is the income in the hands of individuals after deducting income taxes; income available to households to spend and save.
 - c. is the value of goods and services purchased by all levels of government - federal, state, and local - in a given period.
 - d. is the market value of all final goods and services produced by permanent residents of a nation in a given time period.
6. The difference between the Irish gross national product (GNP) and gross domestic product (GDP) is:
 - a. GNP measures Irish output produced regardless of location; whereas GDP measures output produced only in the Ireland.
 - b. GDP measures Irish output produced regardless of location; whereas GNP measures output produced only in the Ireland.
 - c. GNP includes depreciation (capital consumption allowance) whereas GDP excludes depreciation.
 - d. GDP includes depreciation (capital consumption allowance) whereas GNP excludes depreciation.

7. Suppose that nominal GDP is \$6,000 billion and real GDP is \$3,000. What is the GDP price deflator?
 - a. 125
 - b. 150
 - c. 200
 - d. 250
8. John Brown stops looking for work because he believes his prospects are so poor he is unlikely to find a job. The Central Statistics Office would classify John as:
 - a. not in the labour force.
 - b. on layoff.
 - c. unemployed.
 - d. employed as a household worker.
9. The natural rate of unemployment:
 - a. is caused by cyclical business conditions.
 - b. is the normal rate of unemployment around which the unemployment rate fluctuates.
 - c. results from both frictional and cyclical economic conditions.
 - d. is not present when the economy is at the peak of an economic boom.
10. If a country's total population (age 16 and over) is 40 million, with 1 million unemployed and 24 million currently holding jobs,
 - a. the unemployment rate is 2.5 percent and the labour force participation rate is 60 percent.
 - b. the unemployment rate is 4 percent and the labour force participation rate is 60 percent.
 - c. the unemployment rate is 4 percent and the labour force participation rate is 62.5 percent.
 - d. the unemployment rate is 4.2 percent and the labour force participation rate is 96 percent.
11. The unemployment rate is equal to:
 - a. the number of persons unemployed divided by the number employed.
 - b. the number of persons unemployed divided by the number in the labour force.
 - c. the number of persons unemployed divided by the population age 16 and over.
 - d. the number of persons working divided by the population age 16 and over
12. According to the theory of efficiency wages:
 - a. cultural factors are the major cause of the pay gap.
 - b. differences in human capital strongly influence the efficiency of women.
 - c. wages above the equilibrium level are paid by firms in order to increase efficiency and production.
 - d. higher female unemployment explains why it is efficient to pay women less than men.

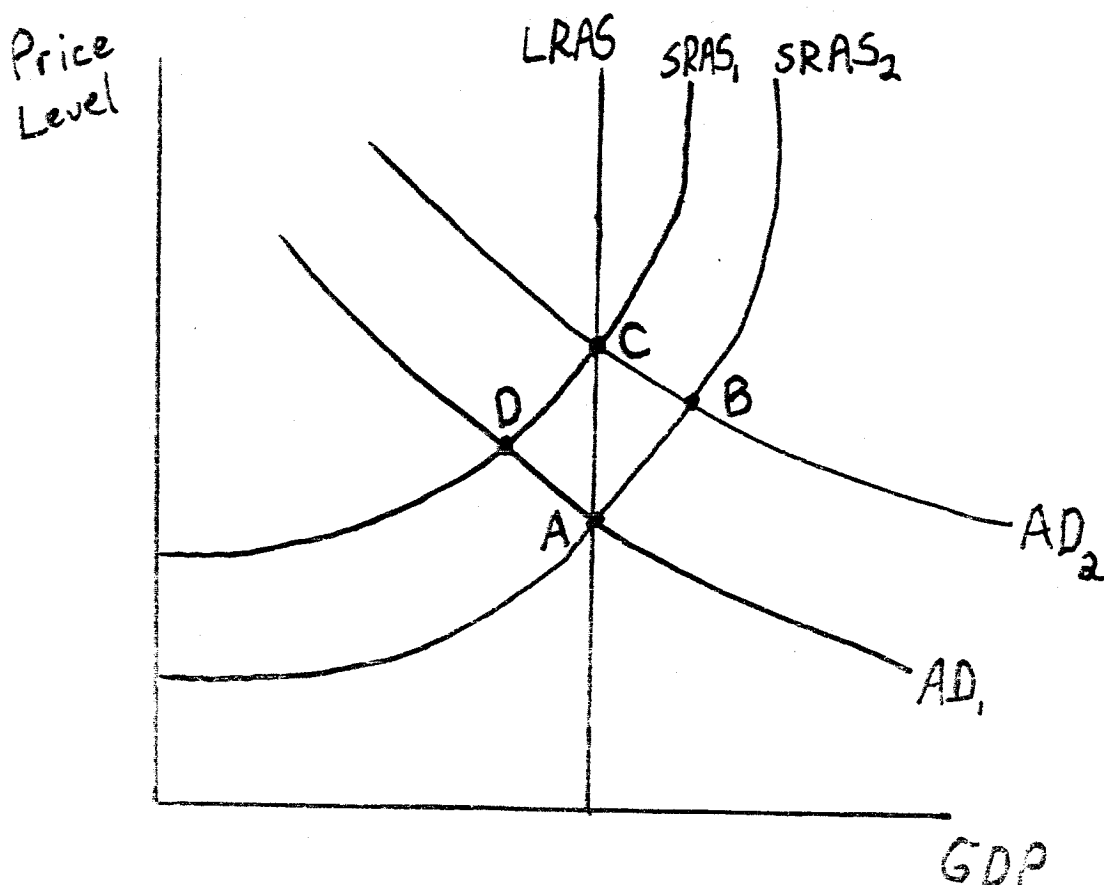
13. The velocity of money is:
- the rate at which the price index for consumer goods rises.
 - the multiple by which an increase in government expenditures will cause output to rise.
 - set by the Director of the Irish Central Bank.
 - the average number of times a pound is used to purchase newly produced goods and services during a year.
14. The relationship of the money demand curve to the value of money is shown by its:
- downward slope.
 - upward slope.
 - horizontal position.
 - vertical position
15. If the monetary authorities continue over time to expand the supply of money more rapidly than real output, the probable result will be:
- inflation.
 - lower nominal interest rates.
 - an increase in real aggregate supply.
 - a decline in the velocity of money.
16. When a currency appreciates, the:
- prices in that country are falling.
 - prices in that country are rising.
 - currency buys fewer units of another currency.
 - currency buys more units of another currency.
17. The trade balance measures:
- the amount of goods a country exports minus the amount of goods it imports.
 - the total amount of foreign exchange entering an economy minus the amount of the country's own currency leaving the country.
 - the amount of a country's assets owned by foreigners minus the amount of foreign assets owned by citizens of the country.
 - the amount of money loaned to foreigners minus the amount borrowed from foreigners.
18. When a country exports more than it imports, it experiences:
- great wealth.
 - inflation.
 - a trade deficit.
 - a trade surplus.

19. The Irish pound would have appreciated if:
- it had been exchanging for one US dollar, but it can now be exchanged for two.
 - Ireland had a balance of trade surplus.
 - it had been exchanging for three US dollars, but it can now be exchanged for two.
 - the number of pounds demanded in the foreign exchange market decreased.
20. A tariff differs from a quota in that:
- a tariff is levied on imports, whereas a quota is imposed on exports.
 - a tariff is levied on exports, whereas a quota is imposed on imports.
 - a tariff is a tax levied by a foreign country, whereas a quota is a limit on the total trade allowed.
 - a tariff is a tax imposed on imports, whereas a quota is an absolute limit to the number of units of a good that can be imported.
21. Which of the following occur during a recession?
- increases in unemployment
 - decreases in real output
 - decreases in real income
 - all of the above
22. If consumer confidence improves sharply, then in the short run:
- aggregate demand shifts left, the price level falls, and real output falls.
 - aggregate demand shifts right, the price level rises, and real output rises.
 - aggregate supply shifts right, the price level falls, and real output rises.
 - aggregate supply shifts left, the price level rises, and real output falls.
23. Critics of policy activism argue that the effects of monetary policy are uncertain due to:
- lags in recognizing the need for policy action.
 - an erratic velocity of money.
 - the general flexibility of prices and wages.
 - erratic behaviour on the part of the Central Bank.
24. In the short run, an open market sale of government securities by the Central Bank will cause:
- the money supply curve to shift to the right.
 - the money supply curve to shift to the left.
 - the rate of interest to fall.
 - the government to pursue a fiscal policy designed to decrease aggregate demand.
25. The "Crowding-Out" effect of government spending refers to
- too many government workers
 - large government surpluses affecting the budget
 - government borrowing affecting the interest rate and private investment
 - the inefficiency of government debt

26. Demand management policies
- were advocated by Keynes
 - refer to boosting the economy during recessions and slowing the economy during booms
 - are always and everywhere effective
 - both (a) and (b)
27. An increase in the price of foreign goods will cause
- the aggregate demand curve to shift down and to the left.
 - the aggregate demand curve to shift up and to the right.
 - the aggregate supply curve to shift up and to the left.
 - the aggregate supply curve to shift down and to the right.
28. The Live Register is usually a larger measure of unemployment than the Labour Force Survey because:
- people such as homemakers are not included in the labour force, yet may receive social welfare benefits
 - unemployed people who are not actively seeking work are not counted as unemployed yet receive social benefits.
 - fraud
 - all of the above
29. Which one of the following statements about Central Bank operations is false?
- Selling government bonds increases the money supply.
 - Selling government bonds increases the interest rate.
 - Buying government bonds increases the money supply.
 - Buying government bonds reduces the interest rate.
30. Looking at labour demand, unemployment occurs because
- the wage is too high.
 - social benefits are too low.
 - the wage is too low.
 - the minimum wage is set too low.

Section B: Short Macroeconomic Questions (85 marks)

For the following questions, read the newspaper article, refer to the provided graph or table, and answer all of the questions. There are nine (9) questions in all.



Answer questions 1-3 based on the above graph.

1. Starting from full employment equilibrium, if the Central Bank bought government bonds, the **short term** effect would be represented by the movement between which two equilibrium points on the above graph?
2. Starting from full employment equilibrium, if the Central Bank bought government bonds, the **long term** effects would be represented by the movement between which two equilibrium points on the above graph?
3. Starting from full employment equilibrium, if there were an increase in the value of the Euro, the **short term** effect would be shown by a movement between which two equilibrium points on the above graph?

Rise in EU inflation may lift interest rates

By Jane Suiter,
Economics Correspondent

RISING inflation across the euro zone will compound pressure on the European Central Bank (ECB) to raise rates over the coming weeks.

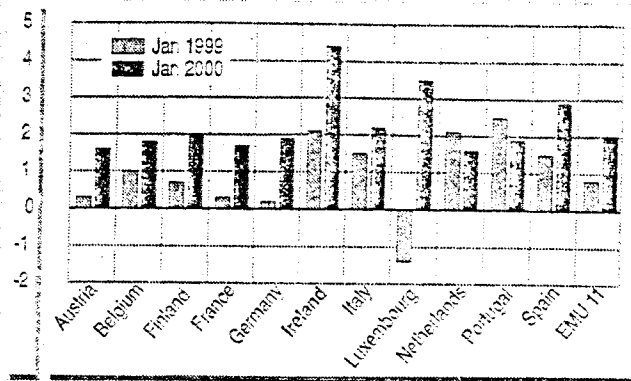
Overall euro zone inflation was running at 2 per cent in January with Ireland topping the league at 4.4 per cent and the Netherlands and Austria at 1.6 per cent, according to figures released yesterday by Eurostat.

The 2 per cent rate, which is at the top end of the ECB's permitted range, was underlined by news that German inflation rose 0.4 per cent in February to bring it to an annual rate of 1.8 per cent.

This combination provides the ECB with all the excuses it needs to increase interest rates at its next meeting tomorrow. However, according to Mr Jim Power, chief economist at Bank of Ireland, the executive board is more likely to wait for the meeting in Madrid on March 30th to raise interest rates to 3.5 per cent from 3.25 per cent.

Not waiting could produce a negative reaction if the markets believed that the rise could knock back growth prospects. Although much of the inflationary surge is the result of rising oil prices, the

EUROZONE INFLATION FIGURES



Source: Eurostat

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ECB is thought to be keen to bring rates back to what it would call a more normal position at around 4 per cent by the end of the year.

Tomorrow's decision will also depend on the behaviour of the euro in the intervening period. Late yesterday the euro currency was calm after pushing upwards earlier in the day following a rumour that the Bundesbank had finally decided to intervene in its support.

If volatility was to increase again and the currency was to fall as it did earlier this week it would

almost certainly rule out a rate rise, according to Mr Power.

The euro closed at \$0.9656 from \$0.9679 and at 60.98p against sterling from 60.83p a day earlier. As a result the pound closed at 77.42p from 77.24p.

And in a piece of potential good news for Irish importers, sterling came under pressure against the dollar following a number of comments from members of the Monetary Policy Committee. The governor of the Bank of England, Mr Eddie George, described sterling as significantly overvalued and said its current levels were unsustainable.

Answer questions 4-6 based on the above Irish Times article from Feb 29, 2000.

- In one short paragraph, explain why an increase in the interest rates will slow inflation.
- In one short paragraph, explain the possible ill effects that an increase in interest rates will have on the European economy.
- In one or two sentences, explain how an increase in the interest rates in Europe will help the value of the Euro.

Gross Domestic Product	1998	1999
Consumption	38,967	43,304
Investment	18,013	21,484
Government Spending	10,136	10,889
Exports	63,874	72,360
Imports	-55,013	-62,505
Total GDP	75,977	85,532

All figures in millions of Euros.

Answer questions 7-9 based on the above table.

7. What is the growth rate in GDP from 1998 to 1999?
8. What percentage of GDP are imports and what percentage are exports in 1999?
9. Are these percentages increasing or decreasing?

Section C. Applied Economics (200 marks)

Please use a separate answer book (s) for this section.

Answer five of the following questions. All questions are worth equal marks.

1. Consider the market for taxi licences in Dublin. Use diagrams to illustrate the relationship between the 'official' market and the secondary market for *taxi licences*.

Illustrate on these diagrams the effect of an increase in the demand for *taxi licences*.

Why has the demand for *taxi services* in Dublin increased in the last ten years?

2. Consider the market for an agricultural commodity that is traded on the world market. Its equilibrium price is 10 Euro's. At this price European consumers can buy all they want. Some European farmers are willing to produce the commodity at this price but most think the price is too low. Suppose European farmers persuade the European Commission to put a tax of 50 per cent on this commodity.

Illustrate carefully on a diagram the effects of this tax (known as a tariff) on (a) European production of this commodity and (b) European consumption of this commodity.

Analyse the welfare effects of this tax on European consumers, (b) European producers and (c) the European Commission. Taking everything into account do you think this is a good policy?

3. What are the distinctive characteristics of information as an economic good? What are the most important developments in the information economy in recent years?

A few years ago a survey in Galway found the following prices of potatoes - £1.99, £2.49, £2.50, £2.79 and £2.99. A survey of electric cookers found the following prices - £199, £205, £210, £220, £221, £223 and £269.

What does economic theory have to say about the amount of time that a consumer will spend searching for low prices?

What effect will this behaviour have on the variation in the prices of goods such as potatoes and cookers?

Explain how you would use the information on the prices of cookers and potatoes to test this theory (you do not have to carry out any calculations but if you can you should explain how the coefficient of variation is calculated).

4. The Economic and Social Research Institute conducts surveys of income distribution and poverty in Ireland. Explain as clearly as you can how poverty is measured in these surveys. Discuss how the extent of poverty has changed in Ireland between 1994 and 1997.

5. Discuss the factors that have been used to explain the rapid economic growth in Ireland over the past ten years.
6. The government is considering building a new motorway between Limerick and Galway. Explain the difficulties in measuring the costs and benefits of such a project.
7. What is the Euro? The introduction of the Euro and its subsequent fall in value have led to discussions in Europe about various economic and monetary policy issues. Which issues have been debated? Outline the debates that have taken place?