GX420

OLLSCOIL NA hÉIREANN, GAILLIMH
NATIONAL UNIVERSITY OF IRELAND, GALWAY

SUMMER EXAMINATIONS 2002

EC217 – MACROECONOMICS
2nd Arts (Economic and Social Studies), St. Angela's College, Sligo

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INSTRUCTIONS

Time Allowed: 3 Hours

There are two sections to this exam for a total of 360 marks.

In Section A, answer **15 out of the 24** short-answer questions (12 marks per question for a total of 180 marks).

In Section B, choose **3 out of the 6** questions to answer (60 marks per question for a total of 180 marks).

Please use a separate Answer Book for each of the two sections.

Note: 3 hours = 180 minutes. 360 marks in 180 minutes equals 2 marks per minute. Allocate your time efficiently.

SECTION A

Answer **15 out of the 24** short-answer questions (12 marks per question or 6 minutes per question).

1. What is meant by Personal Disposable Income? Explain how in a country like Sweden, with very high levels of taxation (55% of GDP), personal disposable income is also high (75% of GDP)?
2. What is meant by the Production function? Sketch a typical production function.
3. Explain, using an example, how a perfectly competitive firm decides how much capital and labour to hire, given the nominal wage rate, the nominal cost of capital, and the price level?
4. Suppose there is an improvement in technology, leading to a rise in productivity. Explain, and illustrate, how will this affect the real wage rate.
5. In terms of the Solow growth model, describe the convergence hypothesis.
6. In the Solow model of economic growth, what are the effects of a higher savings rate on the level of output and on the long-run growth rate of output?
7. Briefly contrast the Solow growth theory with Endogenous growth theory.
8. Illustrate on a diagram the effects of trade unions on the labour market.
9. Why do some firms pay “efficiency wages”?
10. What is meant by frictional unemployment?
11. How might the natural, or equilibrium, rate of unemployment be reduced on a permanent basis?
12. How does the concept of hysteresis apply to European unemployment rates since the mid 1970s?
13. Briefly discuss two effects of a falling nominal exchange rate.
14. What is a trade-weighted, or effective, exchange rate index?
15. Describe any two causes of a rising real exchange rate.
16. What is meant by Purchasing Power Parity? Describe the implications of this theory for a country like Ireland within the eurozone.
17. Discuss how the quantity of money is measured.
18. Discuss two of the three factors that affect the demand for money balances.
19. What causes each of the IS and the LM curves to shift?
20. Explain some of the assumptions underlying the Mundell-Fleming model.
21. What is Okun’s Law?
22. Distinguish between adaptive expectations and rational expectations.
23. Why are many central banks independent from governments?
24. What is Ricardian Equivalence?

SECTION B

Choose **3 out of the 6** questions to answer. Each question is worth 60 marks. The numbers in brackets refer to the marks for the parts of each question.

1 (a) Explain fully the following terms:

1. Gross Domestic Product
2. Net Factor Income sent Abroad
3. GNP at factor cost
4. Investment
5. GDP Deflator (30 marks)

(b) Explain how deficits/surpluses in the private sector, the government sector and the foreign sector relate to each other. Use an equation to illustrate the links between these three sectors. (15)

(c) Carefully explain, using an example, the difference between growth in nominal GDP and growth in real GDP. (15)

2 (a) Use the Solow Growth model to show how improvements in technical progress are the only source of long run growth in incomes per person. (40)

(b) Suggest two ways by which a government might promote stronger economic growth. (10)

(c) Suppose that country A initially has a lower income-per-head than country B. Then country A experiences faster increases in its rate of technological progress than B. Explain and illustrate the effect of this growth over time. (10)

3 (a) In each of the three cases below, explain fully the long run relationships between each of the variables: (50)

1. the money supply, money demand and inflation
2. inflation rates and nominal interest rates
3. inflation rates and the nominal exchange rate

(b) Briefly describe two of the three instruments that a Central Bank can use to influence the money supply. (10)

4 (a) In the context of the long run equilibrium position in an economy, explain what are meant by "money neutrality" and the "classical dichotomy". Also explain how output may be said to be "supply-determined". (20)

(b) Consider a closed economy that is operating at an output level that is below the equilibrium output level. Assuming "sticky" prices, illustrate and explain fully how output may be said to be "demand-determined". (40)

5 "There is always a temporary tradeoff between inflation and unemployment; there is no permanent tradeoff" – Milton Friedman.

(a) In the context of the above quote, consider an economy where output is at its long-run equilibrium level. The government then introduces expansionary demand policies. Explain fully both the short-run and long-run consequences of this action. Also illustrate the effects of this policy on an AD/AS diagram and on a Phillips Curve diagram. (45)

(b) What is meant by disinflation and the sacrifice ratio? (15)

6 (a) In terms of both monetary and fiscal policymaking, discuss the advantages and costs associated with a commitment to rules, rather than discretion? (30)

(b) How does fiscal policy act as an automatic stabiliser during recessions and expansions? (15)

(c) In the context of a sustained economic expansion, explain the advantages of the adjusted budget Balance over the conventional Budget Balance as an indicator of fiscal stance. (15)