

OLLSCOIL NA hÉIREANN, GAILLIMH
NATIONAL UNIVERSITY OF IRELAND, GALWAY

AUTUMN EXAMINATIONS 2002

EC100 ECONOMICS PAPER 2

1st B.A. (Economic and Social Studies), St. Angela's College, Sligo

Professor Michael Keane
Professor Huw Dixon
Mr. Stephen McNena

Time allowed: THREE hours

Marks: 350

Please note that there are specific instructions for each of the three sections in this exam paper: section A, section B and section C (Multiple Choice questions).

SECTION A
(90 marks)

Instructions: Write a short note (maximum two paragraphs) on any **six** of the following:

1. Personal (or household) disposable income
2. The difference between GDP and GNP and its significance in Ireland
3. The three types of expenditures within the Keynesian Model of Income Determination
4. The Keynesian expenditure multiplier in Ireland
5. Supply-side policies
6. Two causes of price inflation
7. Two consequences of inflation
8. Three types of unemployment
9. Two methods of measuring unemployment in Ireland
10. The Current Budget Deficit, the Exchequer Borrowing Requirement and the National Debt

SECTION B
(160 marks)

Instructions: Answer two of the following three questions. All questions are worth 80 marks.

1.

- (a) What are the four factors of production? What are the associated factor incomes?
- (b) Using a well-labelled diagram, draw the circular flow model for a closed economy. Make sure to show both GDP and Personal Disposable Income on the diagram.
- (c) Carefully explain, using a numerical example, the difference between changes in nominal GDP and real GDP.
- (d) Discuss how GDP-per-capita may not be a reliable indicator of the quality of life in a country.
- (e) Below are some data from a closed economy:

Consumption = €45m

Investment = €21m

Income Taxes = €20m

Transfer payments = €8m

Government expenditure on goods and services = €12m

- (i) Calculate national income (GDP) in this closed economy.
- (ii) Calculate personal disposable income.
- (iii) Calculate the value of savings.
- (iv) List, and find the value of, all leakages from this economy.

2.

- (a)
 - (i) List and briefly discuss the three main functions of money.
 - (ii) Discuss two of the reasons that people hold money, as suggested by Keynes.

Suppose the Central Bank is concerned about rising inflation rates. They decide to introduce a reduction in the supply of money. Everything else is held constant.

- (b) Using the Keynesian Theory of Liquidity Preference, illustrate and explain the effects of this action on the money market. What happens to interest rates?
- (c)
 - (i) What is the name given to this type of policy?
 - (ii) Use a well-labelled IS/LM diagram to show the effect of this action on equilibrium output. Will the economy grow faster or slowdown?
 - (iii) Do you think this response by the Central Bank will have the desired effect on inflation? Explain.
- (d) Instead of the Central Bank, explain what type of policy the government might implement to reduce the rate of inflation.

3.

- (a)
 - (i) What is the Balance of Payments?
 - (ii) List and briefly describe the four sub-accounts of the Current Account of the Balance of Payments and give an example of a transaction that is recorded in each.
- (b) The euro / US Dollar exchange rate during a three month period is as follows:

| | |
|----------|-------------|
| January | €1 = \$1.40 |
| February | €1 = \$1.30 |
| March | €1 = \$1.20 |

 - (i) What is an exchange rate?
 - (ii) Between January and March did the dollar depreciate or appreciate?
 - (iii) How would the movement in exchange rates over the three months affect Irish exporters to the USA? Explain.
 - (iv) How would the change in the exchange rates affect imports from the USA to Ireland?
 - (v) What would be the effect of the change in the exchange rate on the Irish economy? How might it affect inflation?
- (c) Ireland, and eleven other EU states, have formed an Economic and Monetary Union (EMU).
 - (i) When did Ireland join EMU?
 - (ii) What is the central feature of EMU?
 - (iii) Outline two benefits and one cost of Ireland's membership of EMU.
 - (iv) Does membership of Economic and Monetary Union (EMU) mean that prices of consumer goods and services are identical across the eurozone? Explain.

SECTION C
Multiple Choice Questions (100 marks)

Please be careful when answering the following Multiple Choice questions. Write your answers in the same order as the questions. Please write clearly and legibly, as the letters "a", "c", and "d" can often be confused. Negative marking applies. (5 marks for a correct answer, 0 marks for an unanswered question and a penalty of -1 mark for an incorrect answer)

1. Which of the following are all examples of leakages from the circular flow
 - (a) imports and exports
 - (b) imports, consumption and transfer payments
 - (c) imports, savings and transfer payments
 - (d) savings, taxes and imports
 - (e) none of the above
2. Which of the following is the more accurate measure of the standard of living in Ireland
 - (a) nominal GDP
 - (b) real GDP per person
 - (c) real GNP per person
 - (d) the interest rate
 - (e) the level of house prices
3. The GDP in a closed economy is made up of
 - (a) consumption, income and savings
 - (b) consumption, transfer payments, investment and exports
 - (c) consumption, savings, investment and government expenditures
 - (d) exports, taxes and savings
 - (e) consumption, investment and government expenditures
4. If the general price level in Ireland is rising by 2% per year, and the volume of goods and services being produced is increasing by 5% per year then
 - (a) nominal GDP is rising at 5% per year
 - (b) real GDP is rising at 3% per year
 - (c) nominal GDP is rising by 7% per year
 - (d) real GDP is increasing at a rate of 7% per year
 - (e) GDP is not increasing
5. Keynes believed that the solution to the large-scale unemployment experienced during the Great Depression was to
 - (a) reduce the growth of wages
 - (b) cut back on government expenditures
 - (c) implement policies to boost the level of aggregate demand in the economy
 - (d) increase interest rates
 - (e) reduce inflation rates

6. The principle assumptions of the Keynesian model of Income Determination are
 - (a) the general price level in the economy is fixed
 - (b) the level of output depends on the level of aggregate expenditure
 - (c) the economy is operating below its maximum capacity
 - (d) all of the above
 - (e) none of the above

7. If the simple Keynesian multiplier is 2, and autonomous expenditure increases by €40 million, the result will be
 - (a) smaller increases in output
 - (b) no change in the level of output
 - (c) output will increase by €42 million
 - (d) output will increase by €80 million
 - (e) output fall by €20 million

8. Imagine an economy with autonomous expenditure of €500 million. The MPC is 0.60. The equilibrium output level in this economy is
 - (a) €300 million
 - (b) €833.33 million
 - (c) €1,250 million
 - (d) €500 million
 - (e) €560 million

9. The broad money supply (M3) consists of
 - (a) all notes plus all coins in circulation
 - (b) currency in circulation plus current accounts in commercial banks
 - (c) currency in circulation plus savings (deposit) accounts
 - (d) currency in circulation, current account balances and savings account balances
 - (e) none of the above

10. In the Keynesian theory of Liquidity Preference, higher incomes will
 - (a) cause interest rates to fall
 - (b) cause the money supply to expand
 - (c) increase both the demand for money and the interest rate
 - (d) cause the demand for money to fall
 - (e) cause the money supply to decrease

11. In the IS/LM model expansionary monetary policy results in
- (a) higher interest rates
 - (b) no change in interest rates
 - (c) lower interest rates and higher output levels
 - (d) higher interest rates and higher output levels
 - (e) lower money supply
12. Which of the following causes an outward shift of the IS curve?
- (a) falling interest rates
 - (b) lower output levels
 - (c) increased government expenditure
 - (d) higher income taxes
 - (e) higher money supply
13. Supply-side policies include
- (a) reducing the interest rate so as to boost consumption
 - (b) causing the Aggregate Demand curve to shift outwards
 - (c) increasing government spending
 - (d) both fiscal policies and monetary policies
 - (e) reforming the labour market to increase the quantity, quality, and flexibility of the labour force
14. A decrease in interest rates
- (a) causes a movement up and to the left along the aggregate demand curve
 - (b) causes a downward shift in the aggregate supply curve
 - (c) causes a decrease in the price level
 - (d) causes a shift outwards of the aggregate demand curve
 - (e) causes an upward shift in the aggregate supply curve
15. Expansionary fiscal or monetary policies cause
- (a) an decrease in the price level
 - (b) a movement down along the Aggregate Demand curve
 - (c) an increase in Aggregate Demand, a rise in output and a rise in the price level
 - (d) a decrease in the rate of inflation
 - (e) a shift in the Aggregate Supply curve

16. An inflation rate of 4% means that

- (a) prices of all goods and service are rising at a rate of exactly 4% per year
- (b) wages are rising at 4%
- (c) the interest rate is also 4%
- (d) prices of goods and services are expected to rise by 4% next year
- (e) the general price level across the economy rose at an average rate of 4% last year

17. Suppose the population of Ireland is 4 million, with 1.7 million of those in employment. There are 100,000 people unemployed. This means that

- (a) the unemployment rate is very high
- (b) the unemployment rate is 2.5%
- (c) the unemployment rate is 5.88%
- (d) the unemployment rate is 5.55%
- (e) the labour force is 1.7 million people

18. The Labour Force Participation Rate measures

- (a) employment
- (b) the size of the working-age population
- (c) the proportion of the working-age population that are either employed or unemployed
- (d) the size of the labour force
- (e) unemployment

19. The Exchequer Borrowing Requirement is

- (a) the same as the Current Budget deficit
- (b) the sum of the Current and Capital budget deficits
- (c) equivalent to the national debt
- (d) the principal cause of a falling national debt
- (e) all of the above

20. Productivity measures

- (a) the growth of incomes per head
- (b) the quantity of output per hour of labour input
- (c) the total production of goods and services in the economy
- (d) the quantity of output per worker
- (e) none of the above