

**Ollscoil na hÉireann, Gaillimh**  
*National University of Ireland, Galway*

**Semester II Examinations, 2004/05**

Exam Code(s)	<u>IBA5</u>
Exam(s)	<u>1<sup>st</sup> BA (Economic and Social Studies)</u>
Module Code(s)	<u>EC100</u>
Module(s)	<u>Economics</u>
Paper No.	<u>2</u>
Repeat Paper.	<u>Special Paper</u>
External Examiner(s)	<u>Professor Vincent Munley</u>
Internal Examiner(s)	<u>Mr. Brendan Kennelly</u>
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**Instructions:**

Students are required to answer **all** multiple choice questions in Section A (100 marks) and any **four** questions in Section B (240 marks). All questions in Section B carry equal marks.

Duration	<u>3hrs</u>
No. of Answer books	<u>          </u>

**Requirements:**

Handout	<u>          </u>
MCQ	<u>          </u>
Statistical Tables	<u>          </u>
Graph Paper	<u>          </u>
Log Graph Paper	<u>          </u>
Other Material	<u>          </u>

No. of Pages	<u>9</u> (Including cover page)
Department(s)	<u>Economics</u>

## SECTION A

### Multiple Choice Questions (100 Marks)

Please write your answers to the following multiple-choice questions on the first page of your answer book. Write your answers in the same order as the questions and use CAPITAL letters only.

Negative marking applies in this section (5 marks for a correct answer, 0 marks for an unanswered question and a penalty of 0.5 for an incorrect answer).

1. If a cobbler buys leather for €100 and thread for €50 and uses them to produce and sell €500 worth of shoes to consumers, the contribution to GDP is
  - (a) €50
  - (b) €100
  - (c) €500
  - (d) €600
  - (e) €650
2. The difference between gross national product (GNP) and gross domestic product (GDP) is accounted for by
  - (a) depreciation
  - (b) indirect taxes
  - (c) transfer payments
  - (d) net factor income from abroad
  - (e) personal taxes
3. Which of the following statements is true about a country with a trade deficit?
  - (a) net capital outflow is positive
  - (b) net exports are negative
  - (c) net exports are positive
  - (d) exports exceed imports
  - (e) none of the above
4. An example of a transfer payment is
  - (a) wages
  - (b) profit
  - (c) rent
  - (d) government purchases
  - (e) unemployment benefits
5. If the reserve requirement is 20 percent, the value of the money multiplier is
  - (a) 0.20
  - (b) 5
  - (c) 4
  - (d) 20

6. An economy that interacts with other economies is known as
  - (a) a balanced trade economy
  - (b) an export economy
  - (c) an import economy
  - (d) a closed economy
  - (e) an open economy
7. Stagflation occurs when the economy experiences
  - (a) falling prices and falling output
  - (b) falling prices and rising output
  - (c) rising output and rising prices
  - (d) rising prices and falling output
8. If the marginal propensity to consume (MPC) is 0.75, the value of the multiplier is
  - (a) 0.75
  - (b) 4
  - (c) 5
  - (d) 7.5
9. An increase in the marginal propensity to consume (MPC)
  - (a) raises the value of the multiplier
  - (b) lowers the value of the multiplier
  - (c) has no impact on the value of the multiplier
  - (d) causes the marginal propensity to save to decrease
  - (e) both (a) and (d) above
10. The classical theory of loanable funds suggests that
  - (a) the interest rate is determined by the Central Bank
  - (b) the interest rate is set according to the money supply
  - (c) the supply of savings and the demand for loans determines the interest rate
  - (d) unemployment is due to a shortage of loanable funds
  - (e) all of the above
11. Which of the following best describes how an increase in the money supply shifts aggregate demand?
  - (a) the money supply shifts right, the interest rate rises, investment decreases, and aggregate demand shifts left
  - (b) the money supply shifts right, the interest rate falls, investment increases, and aggregate demand shifts right
  - (c) the money supply shifts right, prices rise, spending falls, and aggregate demand shifts left
  - (d) the money supply shifts right, prices fall, spending increases, and aggregate demand shifts right

12. Keynes believed that the large-scale unemployment experienced during the Great Depression was due to
- wage rates being too high
  - a deficient level of aggregate demand in the economy
  - very high interest rates
  - oil prices being too high
13. The narrow money supply (M1) consists of
- all coins in circulation
  - currency in circulation plus current accounts in commercial banks
  - currency in circulation plus savings (deposit) accounts
  - currency, current account balances and savings accounts
14. When people take advantage of differences in price for the same good by buying it where it is cheap and selling it where it is expensive, it is known as
- purchasing power parity
  - net capital inflow
  - arbitrage
  - net exports
15. In the long run, a change in which of the following is likely to cause a shift of the aggregate supply (AS) curve?
- welfare expenditure
  - money supply
  - interest rates
  - technology
  - none of the above

The following table contains information about an economy that produces only pens and books. The base year is 2002. Use this information for questions 16 and 17.

Year	Price of Pens (€)	Quantity of Pens	Price of Books (€)	Quantity of Books
2002	3	100	10	50
2003	3	120	12	70
2004	4	120	14	70

16. What is the value of nominal GDP in 2004?
- €800
  - €1,060
  - €1,200
  - €1,460

17. What is the value of real GDP for 2004?
- (a) €800
  - (b) €1,060
  - (c) €1,200
  - (d) €1,460
18. Which of the following is the more accurate measure of the standard of living in Ireland
- (a) GDP
  - (b) GDP per capita
  - (c) GNP
  - (d) GNP per capita
19. Suppose, due to political uncertainty, Americans suddenly decide to purchase European assets rather than American assets. Which of the following statements is true regarding the value of the euro and European net exports?
- (a) the euro appreciates and European net exports fall
  - (b) the euro depreciates and European net exports fall
  - (c) the euro appreciates and European net exports rise
  - (d) the euro depreciates and European net exports rise
  - (e) the euro appreciates and European net exports remain the same
20. The value of the multiplier in an economy where the marginal propensity to save is 0.1, the marginal propensity to import is 0.1 and the marginal propensity to tax is 0.2 is
- (a) 0.4
  - (b) 2.5
  - (c) 0.6
  - (d) 1.67

## SECTION B

### Question 1

**(a) 30 marks**

Explain with the aid of a diagram, the complete circular flow model. List the injections and leakages and explain how these movements into and out of the circular flow can influence the level of economic activity.

**(b) 10 marks**

List and briefly explain the three approaches to measuring economic activity.

**(c) 15 marks**

The following information has been gathered for an imaginary economy:

Item	€bn
Consumer Expenditure (C)	500
Government Expenditure (G)	1,000
Investment (I)	300
Taxes (TX)	700
Transfer Payments (TR)	400
Exports (X)	720
Imports (M)	680

Using the above data calculate the following:

- (i) GDP
- (ii) Disposable income
- (iii) Savings
- (iv) Net exports
- (v) Injections and leakages. Comment on their relative size.

**(d) 5 marks**

- (i) Explain the difference between GDP and GNP. Which is higher in Ireland?

## **Question 2**

### **(a) 35 marks**

Consider a model of the economy described by the following equations:

$$C = 140 + 0.8Y$$

$$I = 300$$

$$G = 150$$

$$X = 250$$

$$M = 0.2Y$$

- (i) What is the equation that describes the aggregate expenditure curve?
- (ii) Calculate the equilibrium level of income algebraically.
- (iii) Show the equilibrium level of income using the Keynesian cross diagram.
- (iv) What is the marginal propensity to (a) consume; (b) save; (c) import?
- (v) What is the value of the multiplier?
- (vi) Suppose the government decides to increase its expenditure on goods and services by 100. What is the new equilibrium level of income?
- (vii) Imagine that the full-employment income level is €2,500. How much would the government have to increase spending by to reach this level of income?

### **(b) 15 marks**

Briefly outline the main differences between the Classical and Keynesian schools of economic thought.

### **(c) 10 marks**

What are the limitations of GDP as a measure of (a) economic welfare and (b) overall welfare in the economy?

## **Question 3**

### **(a) 30 marks**

How would each of the following be likely to affect the value of the euro on the foreign exchange market, all else being equal? Use diagrams to illustrate your answers.

- (i) The European Central Bank announces that it has increased interest rates in the Euro zone.
- (ii) Statistics indicate the inflation in the Euro zone is higher than in the US.
- (iii) Statistics indicate that the level of GDP growth is higher in Europe than in the US.

### **(b) 10 marks**

Describe the economic logic behind the theory of purchasing power parity (PPP). Why in practice, might PPP not hold?

### **(c) 20 marks**

What is fiscal policy? Give an example of a contractionary fiscal policy. What effects would this policy have on the economy?

#### **Question 4**

**(a) 10 marks**

What are the functions of money?

**(b) 15 marks**

Explain Keynes' three motives for holding money.

**(c) 15 marks**

Outline and explain the three tools or instruments of monetary policy that the European Central Bank can use to control the money supply.

**(d) 20 marks**

Suppose the European Central Bank decides to adopt an expansionary monetary policy. Assuming everything else is held constant what impact will this policy have on the money market, investment, consumption and output in the economy? Use three diagrams to illustrate your answer.

#### **Question 5**

**(a) 10 marks**

Draw a long-run aggregate supply (AS) curve. What is the relationship between the price level and the output level in the long run?

**(b) 10 marks**

List and explain three things that might cause the short-run aggregate supply curve to shift.

**(c) 10 marks**

List and fully explain two reasons why the aggregate demand curve slopes downwards.

**(d) 30 marks**

Consider an economy that is in a long-run equilibrium.

- (i) Use a diagram to illustrate the state of the economy. Be sure to show aggregate demand, short-run aggregate supply, and long-run aggregate supply.
- (ii) Now suppose that a stock market crash occurs. Use your diagram to show what happens to output and the price level in the short run. What happens to the unemployment rate?
- (iii) What action can the government take to offset the negative effects of the stock market crash?
- (iv) Explain how the economy will get back to long-run equilibrium assuming the government does not intervene to offset the negative effects of the stock market crash.



### **Question 6**

**(a) 5 marks**

Explain the term 'inflation'.

**(b) 15 marks**

List and fully explain three possible effects of inflation.

**(c) 15 marks**

- (i) Explain what is meant by the CPI.
- (ii) List and explain two reasons why the CPI might overstate inflation.
- (iii) What is the HICP and how does it differ from the CPI?

**(d) 10 marks**

Explain two causes of inflation. Suggest how each cause can be tackled.

**(e) 15 marks**

- (i) Define the term 'unemployment'?
- (ii) How is unemployment measured in Ireland?
- (iii) Outline and briefly discuss three types of unemployment.