926

Ollscoil na hÉireann, Gaillimh

National University of Ireland, Galway

Semester II Examinations, 2004/2005

Exam Code(s)	1BC1, 1BC4, 1CL1,
Exam(s)	1st Comm., 1st Comm. (Spanish), 1st Corp. Law (Legal French)
Module Code(s)	EC100
Module(s)	Economics
Paper No.	2
Repeat Paper	Same Paper
External Examiner(s)	Professor Vincent Munley
Internal Examiner(s)	Mr. Brendan Kennelly

Instructions: **Students are required to answer all questions in Section A (150 marks) on the MCQ answer sheet provided, and any 4 questions in Section B (225 marks). In Section A, select no more than one option for each question. For each question in Section A, you will receive 6 marks for a correct answer, a score of –1.5 for an incorrect answer and a score of 0 if the question is not answered. All questions in Section B carry equal marks.**

Duration	3 hrs.
No. of Answer books	MCQ 3

Requirements:

Handout	
MCQ	Section A
Statistical Tables	
Graph Paper	
Log Graph Paper	
Other Material	
No. of Pages	11
Department(s)	Economics

Section A

Select no more than one option for each question and carefully follow the instructions on the MCQ answer sheet. For each question in Section A, you will receive 6 marks for a correct answer, a score of –1.5 for an incorrect answer and a score of 0 if the question is not answered.

1. According to the crowding-out effect, an increase in government spending
   a. increases the interest rate and so increases investment spending.
   b. increases the interest rate and so decreases investment spending.
   c. decreases the interest rate and so increases investment spending.
   d. decreases the interest rate and so decreases investment spending.

2. People will want to hold less money if the price level
   a. or the interest rate increases.
   b. or the interest rate decreases.
   c. increases or the interest rate decreases.
   d. decreases or the interest rate increases.

3. Which combination of events described below would be the most contractionary for an economy, assuming that they all happened at the same time?

	Taxes	Government spending	Net exports	Reserve requirement
(a)	decrease	increase	increase	decrease
(b)	increase	increase	increase	decrease
(c)	decrease	increase	decrease	decrease
(d)	decrease	decrease	decrease	decrease
(e)	increase	decrease	decrease	increase

4. Reserve requirements set by the European Central Bank (ECB) are the

   (a) minimum values of the bank reserves to bank deposits that commercial banks are allowed to maintain
   (b) maximum values of the bank reserves to bank deposits that commercial banks are allowed to maintain
   (c) minimum amount of currency banks must hold in their vaults
   (d) maximum amount of currency banks are allowed to hold in their vaults
   (e) minimum amounts of bonds commercial banks must purchase from the ECB

5. Suppose the European Central Bank engages in an open market purchase and, at the same time, it raises the reserve requirement,

(b) the money should remain unchanged
(c) the money supply should rise
(c) the money supply should fall
(d) we cannot be sure what will happen to the money supply
(e) consumer confidence in the banking system will fall

6. 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

(a) purchasing-power parity
(b) net capital outflow
(c) arbitrage
(d) net exports
(e) currency appreciation

7. The main refinancing interest rate (MRIR) is

(a) the interest rate the Federal Reserve charges on reserves
(b) the interest rate the European Central Bank pays on reserves
(c) the interest rate the European Central Bank charges on loans to the banks
(d) the interest rate the European Central Bank pays to bond-holders
(e) the interest rate the public in Ireland pays when borrowing from European commercial banks

8. The quantity theory of money concludes that an increase in the money supply causes

(a) a proportional increase in velocity
(b) a proportional increase in prices
(c) a proportional increase in real output
(d) a proportional decrease in velocity
(e) a proportional decrease in prices

9. Suppose, the inflation rate over the last 20 years has been 10% in Great Britain, 7% in Japan and 3% in the United States. If purchasing power parity holds, which of the following statements is true? Over this period:

(a) the value of the dollar should have fallen compared to the value of the pound and the yen
(b) the yen should have risen in value compared to the pound and fallen compared to the dollar
(c) the yen should have fallen in value compared to the pound and risen compared to the dollar
(d) the value of the pound should have risen compared to the value of the yen and the dollar
(e) none of the above

10. A fixed exchange rate is an exchange rate whose value:

(a) is determined by the law of one price
(b) varies according to the supply and demand for the currency in the foreign exchange market
(c) is set by official government policy
(d) reflects the comparative advantage of the home country versus other foreign countries
(e) is established annually by the International Monetary Fund

11. Stagflation occurs when the economy experiences

(a) falling prices and falling output
(b) falling prices and rising output
(c) rising prices and rising output
(d) rising prices and falling output
(e) rising interest rates and rising output

12. Which of the following is an automatic stabilizer?

(a) military spending
(b) spending on primary schools
(c) spending on transport infrastructure.
(d) unemployment benefits
(e) increase in wages for public servants

13. Which of the following best illustrates the difference between GDP and GNP?

(a) GDP measures the goods and services consumed by the citizens of a country, while GNP measures output exported to other countries
(b) GDP measures output produced by the citizens within a country, while GNP measures output produced by non-citizens within a country
(c) GDP measures the output produced by the citizens of a country, while GNP measures output produced within the borders of a country
(d) GDP measures the output produced within the borders of a country, while GNP measures output produced by the citizens of a country
(e) GDP measures goods produced by the citizens of a country, while GNP measures the expenditure on goods and services by the citizens of a country

14. According to the model of aggregate demand and aggregate supply, in the long run, an increase in the money supply should cause:

(a) prices to rise and output to rise
(b) prices to fall and output to fall
(c) prices to rise and output to remain unchanged
(d) prices to fall and output to remain unchanged
(e) investment to fall and output to fall

15. Which of the following events shift the short-run aggregate supply curve to the right?

(a) an increase in government expenditure on unemployment benefits
(b) a increase in price expectations
(c) a drop in oil prices
(d) a decrease in the money supply
(e) a fall in the education participation rate

16. Economists who argue that policymakers should not try to stabilise the economy make **all** of the following arguments **except**:

(a) since stabilisation policy affects the economy with a lag, well-intended policy could be destabilising
(b) since forecasting shocks to the economy is difficult, well-intended policy could be destabilising
(c) stabilisation policy has no effect on the economy in the short-run or the long-run
(d) the first rule of policymaking should be "do no harm"
(e) since implementation lags can be difficult well-intended policy could be destabilising

17. If the reserve requirement is 25%, the value of the money multiplier is

(a) 0.25
(b) 4
(c) 5
(d) 25
(e) none of the above

18. Suppose that, due to economic 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

19. Which of the following groups would be hurt most by unanticipated inflation?

(a) borrowers with fixed rate loans
(b) borrowers with variable rate loans
(c) lenders
(d) both borrowers and lenders are hurt the same
(e) neither borrowers nor lenders are hurt by unanticipated inflation, they both benefit

20. George buys and lives in a newly constructed home he paid €200,000 for in 2003. He sells the house in 2004 for €225,000.
   a. The 2004 sale increases 2004 GDP by €225,000 and does nothing to 2003 GDP.
   b. The 2004 sale increases 2004 GDP by €25,000 and does nothing to 2003 GDP.
   c. The 2004 sale does not increase 2004 GDP and does nothing to 2003 GDP.
   d. The 2004 sale increases 2004 GDP by €225,000 and 2003 GDP is revised upward by €25,000.

21. A German citizen buys an automobile produced in the United States by a Japanese company. As a result,
   a. U.S. net exports increase, U.S. GNP and GDP are unaffected, Japanese GNP increases, German net exports decrease, and German GNP and GDP are unaffected.
   b. U.S. net exports, GNP, and GDP increase, Japanese GDP increases, German net exports decrease, and German GDP is unaffected.
   c. U.S. net exports and GDP increase, Japanese GNP increases, German net exports decrease, and German GDP and GNP are unaffected.
   d. U.S. net exports, GNP, and GDP are unaffected, Japanese GNP increases, German net exports decrease, and German GDP and GNP fall.

22. Suppose the money multiplier is equal to 4. If you deposit €100 into a checking account at a bank, this action <u>by itself</u>

   (a) does not change the money supply.
   (b) increases the money supply by €100.
   (c) decreases the money supply.
   (d) has an indeterminate effect on the money supply
   (e) Increases the money supply by €400

23. Suppose the reserve ratio is 10 percent, the public holds all their cash in checking accounts, and banks do not hold excess reserves. When the European Central Bank sells €10 million of bonds to the public, bank reserves

   (a) Increase by €1 million and the money supply eventually increases by €10 million.
   (b) Increase by €10 million and the money supply eventually increases by €100 million.
   (c) Decrease by €1 million and the money supply eventually increases by €100 million.
   (d) Decrease by €10 million and the money supply eventually decreases by €10 million
   (e) Decrease by €10 million and the money supply eventually decreases by €100 million.

24. If stock markets in the Euro Zone crash,

(a) Aggregate expenditure increases, which the European Central Bank could offset by increasing the money supply.
(b) Aggregate expenditure increases, which the European Central Bank could offset by decreasing the money supply.
(c) Aggregate expenditure decreases, which the European Central Bank could offset by increasing the money supply.
(d) Aggregate expenditure decreases, which the European Central Bank could offset by decreasing the money supply.
(e) Aggregate expenditure decreases, which the European Central Bank could offset by decreasing taxes in the Euro Zone.

25. The American government buys an airplane that is made by Boeing in Seattle. Boeing hires extra workers. The workers increase their spending. Firms that the workers buy goods from increase their output. This type of effect on spending illustrates

(a) The crowding-out effect.
(b) The multiplier effect.
(c) The marginal propensity to consume effect.
(d) The purchasing power parity effect
(e) None of the above is correct.

Section B

Students are required to answer any 4 questions in Section B (225 marks). All questions in Section B carry equal marks. Please indicate clearly on the front page of your answer book which questions you have attempted. If you attempt all of the questions, only the first four will be corrected – unless you indicate clearly which questions you wish to be corrected.

1.

a. Who is Jean Claude Trichet? Why is it important for Irish households and businesses to understand what Jean Claude Trichet says? **(8 marks)**

b. What is the main policy objective of the European Central Bank (ECB)? How has this objective been interpreted by the ECB? Do you think the ECB has been successful in meeting its policy objectives? **(12 marks)**

c. Outline the two main monetary policy instruments employed by the ECB and explain briefly how they work. **(11 marks)**

d. In March, the European Central Bank reported that inflation was 0.2 per cent in Finland and over 4 per cent in Greece. What difficulties does the European Central Bank face in responding to such different inflation rates? **10 marks)**

e. Explain fully three problems that commonly arise in measuring the cost of living. **(15 marks)**

2. There are four reasons why the aggregate demand curve slopes downward. List and explain fully any **three** of these reasons. **(27 marks)**.

Consider an economy that initially is in long-run equilibrium. Suppose something happens that reduces aggregate demand but has no effect on either long-run or short-run aggregate supply.

Give an example of something that might cause aggregate demand to fall. **(6 marks)**

Use a diagram to show the short-run effect of this event on the price level and aggregate output. Indicate clearly on your diagram the price level and the level of output before and after that fall in aggregate demand **(10 marks)**.

Explain how the economy will get back to long-run equilibrium assuming the government does not adjust aggregate demand **(8 marks)**.

What will happen to output and prices if the government increases government spending after the fall in aggregate demand? **(7 marks)**

3. Consider the following model of income determination in an economy.

$C = 1,000 + 0.75\ (Y - T)$; $I^P = 1,000$; $G = 1,500$; $NX = -600$; $T = 1200$; $Y^* = 8,600$

Where C = consumption expenditure, Y = national output (income), T = taxes, I^P = planned investment, G = government purchases, NX = net exports and Y* = potential output.

(a) Suppose Y = 6,000. What is aggregate expenditure when Y = 6,000? What will happen to inventories if Y = 6,000? **(7 marks)**

(b) Find the equilibrium level of output **(7 marks)**.

(c) What is the multiplier in this model? **(7 marks)**

(d) By how much would government purchases have to increase to move the economy from the original equilibrium level to potential output? **(7 marks)**

(e) Alternatively, by how much would the government have to reduce taxes to move the economy from the original equilibrium level to potential output **(7 marks)**?

(f) This kind of macroeconomic model suggests that precise use of fiscal policy can eliminate short-run output gaps. Outline and explain three qualifications about the use of fiscal policy to manage the macro economy situation in Ireland **(12 marks)**.

(g) What assumptions are made about prices and price-setting behaviour in this kind of model? **(9 marks)**

4. Consider the following data which refers to a fictitious country, Freedland.

	Price level (1998 = 100)	Real GDP (Millions of euros)	Potential GDP (Millions of euros)
1998	100	65,000	75,000
1999	105	78,000	80,000
2000	120	84,000	84,000

Draw one diagram to show how the economy of Freedland changed between 1998 and 1999. The diagram should include an aggregate demand curve, a short-run aggregate supply curve and a long-run aggregate supply curve for both years (so the diagram should have 6 curves). **(16 marks)**

Suppose that full employment in Freedland is 4 per cent. What do you think the unemployment rate in Freedland might have been in 1998 and 1999? **(6 marks)**

Identify three factors that determine the position of the long-run aggregate supply curve? Outline and explain two policy initiatives that the Irish government could use to shift the long-run aggregate supply curve to the right. **(14 marks)**

"GDP is a perfect measure of well-being". Discuss. **(20 marks)**

5. Consider the market for money in the Euro Zone. Assume that the European Central Bank determines exactly the supply of money in the Euro Zone. Explain using diagrams what, if anything, would happen to the supply of money, the demand for money and nominal interest rates when (a) the European Central Bank's bond traders sell bonds in open-market operations, (b) more supermarkets begin to accept credit cards in payment and (c) there is an increase in the price level in the economy. Draw a separate diagram for each event. **(27 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 answer. **(14 marks)**

a. More Americans decide to visit countries in the Euro Zone.

b. The European Central Bank announces that it has reduced interest rates in the Euro Zone.

What is the difference between real variables and nominal variables in macroeconomics? Give an example of each, and explain the importance of this distinction in one of the macroeconomic models that you studied in the course. **(15 marks)**