

Ollscoil na hÉireann, Gaillimh
National University of Ireland, Galway
Semester II Examinations, 2004/2005

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Exam(s)	1 st Arts, 1 st Arts (PSP), 1 st Comm. (French), 1 st Comm. (German), 1 st Comm. (Italian), 1 st B.Sc. (IF), 1 st Corp. Law (MIS or German or Spanish), 1 st B.Sc. (Fin. Maths. & Ec.)
Module Code(s)	EC100
Module(s)	Economics
Paper No.	2
Repeat Paper	None
External Examiner(s)	Professor Vincent Munley
Internal Examiner(s)	Mr. Brendan Kennelly Dr. Eamon O'Shea

Instructions:

Students are required to answer all questions in Section A (40 per cent) on the MCQ answer sheet provided, and any 4 questions in Section B (60 per cent). In Section A please choose only 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

Requirements:

Handout _____
 MCQ Section
 A

Statistical Tables _____
 Graph Paper _____
 Log Graph Paper _____
 Other Material _____

No. of Pages 10

Department(s) Economics

Section A

You must answer all questions. Please choose only one option for each question

1. Some frictional unemployment is inevitable because:
 - (a) efficiency wages may hold the wage above the equilibrium wage
 - (b) of minimum wage laws
 - (c) there are changes in the demand for labour among different firms
 - (d) of unions
 - (e) all of the above.

2. Real GDP is measured in _____ prices while nominal GDP is measured in _____ prices
 - (a) current year; base year
 - (b) base year; current year
 - (c) intermediate; final
 - (d) domestic; foreign
 - (e) foreign; domestic.

3. Irish GDP would exclude which of the following:
 - (a) services of a solicitor purchased by a home buyer
 - (b) landscaping services purchased by a home owner
 - (c) new road investment by Galway County Council built by Irish-based construction company employing some foreign workers
 - (d) Irish Timber purchased by Wicklow Garden Sheds Ltd.
 - (e) purchase of a new computer produced in Limerick.

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

	<u>Taxes</u>	<u>Government spending</u>	<u>Net exports</u>	<u>Reserve requirement</u>
(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

5. 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 amount of bonds commercial banks must purchase from the ECB.
6. When Central Bank actions cause interest rates on newly issued bonds to increase from 5% to 6%, the price of existing bonds:
- (a) increase
 - (b) decrease
 - (c) remain unchanged
 - (d) increase only if the coupon rate is less than 6%
 - (e) increase only if the coupon rate is greater than 6%.
7. Suppose the European Central Bank engages in an open market purchase and, at the same time, it raises the reserve requirement,
- (a) the money supply should remain unchanged
 - (b) 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.
8. If the reserve requirement is 25 per cent, the value of the money multiplier is:
- (a) 0.25
 - (b) 4
 - (c) 5
 - (d) 25
 - (e) 4,000.

9. 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.
10. 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.
11. 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.
12. 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.

13. 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.
14. 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.
15. Suppose the economy is initially in long-run equilibrium. Then suppose there is a reduction in government spending due to the completion of a major government investment programme in roads. According to the model of aggregate demand and aggregate supply, what happens to prices and output in the long-run?
- (a) prices fall; output is unchanged from its initial value
 - (b) prices rise; output is unchanged from its initial value
 - (c) output rises; prices are unchanged from the initial value
 - (d) output falls; prices are unchanged from the initial value
 - (e) output and the price level are unchanged from their initial value.
16. 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) an increase in wages for public servants.

17. According to the interest rate effect, aggregate demand slopes downward (negatively) because:
- (a) lower prices increase the value of money holdings and consumers spending increases
 - (b) lower prices decrease the value of money holdings and consumers spending decreases
 - (c) lower prices reduce money holdings, increase lending, interest rates fall, and investment spending increases
 - (d) lower prices increase money holdings, decrease lending, interest rates rise, and investment spending falls
 - (e) wealth and exchange rates dominate.
18. In the long-run, as people adjust their expectations fully, the Phillips curve
- (a) is positively sloped
 - (b) is negatively sloped
 - (c) is horizontal
 - (d) is vertical
 - (e) has a slope that is determined by how fast people have adjusted their price expectations.
19. 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.
20. 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.

21. 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) an 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.
22. The value of the multiplier in an economy where the marginal propensity to consume = 0.90, autonomous consumption is €100, the marginal propensity to import = 0.20 and the marginal propensity to tax = 0.15 is:
 - (a) 3.8
 - (b) 2.2
 - (c) 10.0
 - (d) 1.1
 - (e) 5.0
23. 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 protracted, well-intended policy could be destabilising.
24. During the 1990s the main policy strategy of the Central Bank of Ireland was
 - (a) exchange rate targeting
 - (b) interest rate targeting
 - (c) inflation targeting
 - (d) control of broad money supply M3
 - (e) control of narrow money supply M1.
25. According to the Central Statistics Office, a husband who chooses to stay at home and take care of the household is:
 - (a) structurally unemployed
 - (b) employed
 - (c) not in the labour force
 - (d) a discouraged worker
 - (e) frictionally unemployed.

Section B

You must answer four questions. All questions carry equal marks

1. (a) (40 marks)

List and briefly explain the three approaches to measuring economic activity. Using the circular flow diagram, explain why, in principle, they yield the same result

(b) (20 marks)

The following table contains information about an economy that produces only bread and wine. The base year is 2002.

Year	Quantity of bread	Price of bread	Quantity of wine	Price of wine
2002	100	€3	50	€10
2003	120	€3	70	€12
2004	120	€4	70	€14

- Calculate real GDP in 2003
- What is the value of the GDP deflator in 2003?
- What is the value of nominal GDP for 2004?
- What is the percentage increase in real GDP from 2003 to 2004?
- Why do economists use real GDP rather than nominal GDP to gauge economic well-being?

(c) (20 marks)

For Ireland, does GDP or GNP provide a more accurate measure of economic activity? Support your answer.

(d) (20 marks)

Comparisons of GDP across countries (particularly among countries at different levels of economic development) and across long periods of time within countries can sometimes be biased. Explain this statement.

2. (a) (50 marks)

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

$$C = 110 + 0.8Y$$

$$\bar{I} = 300$$

$$\bar{G} = 150$$

$$\bar{X} = 250$$

$$M = 0.2Y$$

- i. Calculate the equilibrium level of income algebraically
- ii. Show the equilibrium level of income using the Keynesian cross diagram
- iii. What is the value of the multiplier in the above model?
- iv. Suppose the government decides to double its expenditure on goods and services. What is the new equilibrium level of income?
- v. Suppose the government wants to increase national income by €50 million. By how much should the government increase its spending on goods and services to achieve this objective?

(b) (25 marks)

What particular problems have arisen in the application of Keynesian economic policies in Ireland in the past three decades?

(c) (25 marks)

Outline the various factors (both short-term and long-term) that have contributed to the recent high rates of economic growth in Ireland.

3. (a) (40 marks)

Explain Keynes' three motives for holding money, paying particular attention to how one part of the demand for money is influenced by what happens in the bond market.

(b) (20 marks)

Explain, using an example, the money multiplier process in a fractional reserve banking system.

(c) (20marks)

List and explain three tools that the European Central Bank uses to influence the money supply.

(d) (20marks)

Explain, with the aid of a diagram(s), the classical theory of inflation.

4. (a) (40 marks)

Examine four factors that shift demand and supply curves in foreign exchange markets. Use diagrams to show the potential influences of the various factors on exchange rates.

(b) (20 marks)

Examine purchasing power parity as a theory of how exchange rates are determined.

(c) (20 marks)

What are the economic implications of a strong (appreciating) euro for Ireland?

(d) (20 marks)

Explain why net exports and net capital outflow are two sides of the same coin, in that these two imbalances offset each other.

5. (a) (30 marks)

Explain, in detail, the reasons why the aggregate demand curve slopes downward.

(b) (50 marks)

The effect of any given shift in aggregate demand will be divided between a change in real output and a change in the price level, depending on the conditions of aggregate supply. Discuss this statement using diagrams to illustrate your answer.

(c) (20 marks)

Show, using a diagram, how an aggregate supply side shock can cause stagflation.