

CARLETON UNIVERSITY

FINAL
EXAMINATION
April 2011

DURATION: 2.5 HOURS

No. of Students: 1500

Department Name & Course Number: ECON 1000/ECON 1002 A, B, C, D, V

Course Instructor(s): N. Rowe, D. Smith, G. Kowalski, T. Joseph, M. Francis

AUTHORIZED MEMORANDA

None

Students **MUST** count the number of pages in this examination question paper before beginning to write, and report any discrepancy to a proctor. This question paper has seven (7) pages.

This examination paper **MAY** be taken from the examination room.

In addition to this question paper, students require: two (2) examination booklets yes no
a Scantron sheet yes no

PLEASE READ ALL INSTRUCTIONS CAREFULLY

Note: This examination has three (3) sections.

PART A: MULTIPLE CHOICE (20 questions, 2 marks each). Answer ALL questions. Detach answer sheet from examination paper and hand in answer sheet with exam booklets. **USE BLOCK CAPITAL LETTERS. (Total 40 Marks).**

PART B: SHORTER QUESTIONS: Answer any FIVE (5) of the questions. Each question is worth 8 marks. Answer in main exam booklet. **(Total 40 Marks)**

PART C: LONGER QUESTIONS: Answer any ONE (1) of the questions. Each question is worth 20 marks. Answer in extra exam booklet **(Total 20 Marks)**

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PART A. Multiple Choice

Identify the choice that best completes the statement or answers the question.

- 1). Goods that go into inventory and are not sold during the current period are
 - a. counted as intermediate goods and so are not included in current period GDP.
 - b. counted in current GDP only if the firm that produced them sells them to another firm.
 - c. included in current period GDP as inventory investment.
 - d. included in current period GDP as consumption.

- 2). The substitution bias in the consumer price index refers to the
 - a. substitution of new goods for old goods in the purchases of consumers.
 - b. substitution of quality for quantity in consumer purchases over time.
 - c. fact that consumers substitute toward goods that have become relatively less expensive.
 - d. substitution of new prices for old prices in the basket of goods from one year to the next.

- 3). The traditional view of the production process is that capital is subject to
 - a. constant returns.
 - b. increasing returns.
 - c. diminishing returns.
 - d. diminishing returns for low levels of capital, and increasing returns for high levels of capital.

- 4). Suppose that in a closed economy GDP is equal to 10,000, taxes are equal to 2,500 Consumption equals 6,500 and Government expenditures equal 2,000. What are private saving, public saving, and national saving?
 - a. 1500, 1000, 500
 - b. 1000, 500, 1500
 - c. 500, 1500, 1000
 - d. None of the above are correct.

- 5). The source of the supply of loanable funds
 - a. is saving and the source of demand for loanable funds is investment.
 - b. is investment and the source of demand for loanable funds is saving.
 - c. and the demand for loanable funds is saving.
 - d. and the demand for loanable funds is investment.

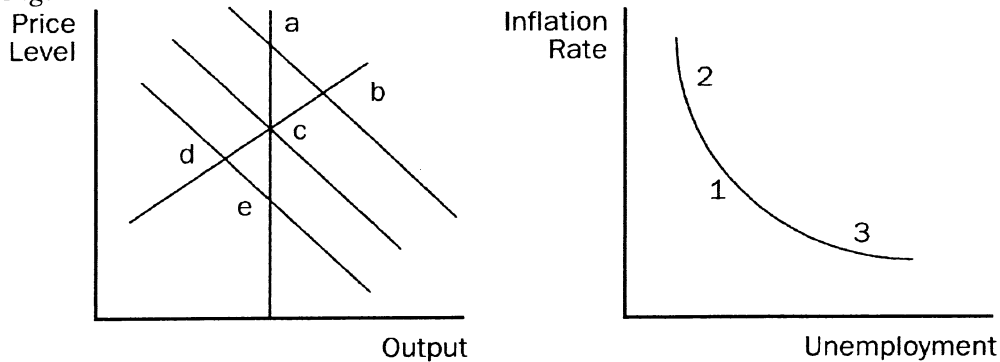
- 6). Consumers decide to buy more computers and fewer typewriters. As a result, computer companies expand production while typewriter companies lay-off workers. This is an example of
 - a. structural unemployment created by efficiency wages.
 - b. cyclical unemployment created by a recession.
 - c. frictional unemployment created by a sectoral shift in demand.
 - d. None of the above are correct.

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- 7). If the public decides to hold more currency and fewer deposits in banks, bank reserves
- decrease and the money supply eventually decreases.
 - decrease but the money supply does not change.
 - increase and the money supply eventually increases.
 - increase but the money supply does not change.
- 8). During recessions, banks typically choose to hold more excess reserves relative to their deposits. This action
- increases the money multiplier and increases the money supply.
 - decreases the money multiplier and decreases the money supply.
 - does not change the money multiplier, but increases the money supply.
 - does not change the money multiplier, but decreases the money supply.
- 9). According to the classical dichotomy, which of the following is *not* influenced by monetary factors?
- nominal GDP and nominal interest rates
 - real wages and real GDP
 - the price level and nominal GDP
 - None of the above are correct.
- 10). The money supply in Freedonia is \$200 billion. Nominal GDP is \$800 billion and real GDP is \$400 billion. Assuming that velocity is stable, if real GDP grows by 10 percent this year, and if the money supply does not change this year, then
- the inflation rate will be zero.
 - nominal GDP will grow by 10 percent.
 - nominal GDP will stay the same.
 - none of the above are correct.
- 11). The nominal interest rate is 5 percent and the inflation rate is 2 percent. What is the real interest rate?
- 7 percent.
 - 6 percent.
 - 5 percent.
 - 3 percent.
 - 3 percent.
- 12). Wealth is distributed from creditors to debtors when inflation is
- high, whether it is expected or not.
 - low, whether it is expected or not.
 - unexpectedly high.
 - unexpectedly low.
- 13). A country has \$150 million of net exports and \$190 million of saving. Net capital outflow is
- \$40 million and domestic investment is \$190 million.
 - \$40 million and domestic investment of \$150 million.
 - \$150 million and domestic investment is \$40 million.
 - \$190 million and domestic investment is \$40 million.
 - \$190 million and domestic investment of \$150 million.

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- 14). Investment spending increases when the price level
- rises causing interest rates to rise.
 - rises causing interest rates to fall.
 - falls causing interest rates to rise.
 - falls causing interest rates to fall.
- 15). When the government spends more, the initial effect is that
- aggregate demand shifts right.
 - aggregate demand shifts left.
 - aggregate supply shifts right.
 - aggregate supply shifts left.
 - a movement along the aggregate demand curve occurs.
- 16). The effects of an increase in the price level that is greater than expected are shown by
- shifting the short-run aggregate supply curve right.
 - shifting the short-run aggregate supply curve left.
 - moving to the right along a given aggregate supply curve.
 - moving to the left along a given aggregate supply curve.
- 17). According to liquidity preference theory, the money demand curve is downward sloping because
- interest rates rise as Bank of Canada reduces the quantity of money demanded.
 - interest rates fall as Bank of Canada reduces the supply of money.
 - people will want to hold less money as the cost of doing so falls.
 - people will want to hold more money as the cost of doing so falls.
- 18). If the short-run Phillips curve were stable, which of the following would be unusual?
- an increase in inflation and an increase in output
 - a decrease in inflation and an increase in unemployment
 - an increase in both inflation and unemployment
 - an increase in output and a decrease in unemployment

Use the pair of diagrams below to answer question 19.

Figure 1



19). Refer to Figure 1. If the economy starts at c and 1, then in the short run, an increase in government expenditures moves the economy to

- b and 2.
- b and 3.
- d and 3.
- d and 2.

20). Which of the following is true concerning the long-run Phillips curve?

- Its position is determined primarily by monetary factors.
- If it shifts right, long-run aggregate supply shifts right.
- It cannot be changed by any government policy.
- its position depends on the natural rate of unemployment.

PART B.

Short Answer. Use the main booklet. Answer **ANY FIVE** questions. Each question is worth 8 marks.

1. A) Explain how the Consumer Price Index is calculated.

B) The average person in 2010 buys 10 apples at \$4 each, and 10 bananas at \$6 each. In 2011 apples rise to \$5 each and bananas rise to \$7 each. Calculate the inflation rate. (You will not need a calculator!)

C) Explain one reason why the CPI might be biased, and whether it would overestimate or underestimate inflation.

2. What is productivity? Explain how an increase in savings affects productivity and long run growth.

3. A) Explain what is meant by "Purchasing Power Parity".

B) If a cup of coffee costs \$2 in Canada, and 100 shillings in Kenya, what would Purchasing Power Parity predict the Kenyan shilling to be worth in Canadian dollars? Explain.

C) If Kenya had 10% inflation, and Canada had 2% inflation, what would Purchasing Power Parity predict would be happening to the exchange rate between the Kenyan shilling and the Canadian dollar over time? Explain.

- NA
4. Draw a graph for the market for loanable funds in a closed economy. Show and explain what happens to the rate of interest and investment if the government increases spending by \$100 million without increasing taxes. Will investment rise or fall? By exactly \$100 million, or more or less than \$100 million? Explain.
 5. A) If the Bank of Canada buys \$100 million worth of bonds in an open market operation, explain how this will affect the money supply.
B) Explain how commercial banks' reserve ratios will affect the size of the change in the money supply.
 6. Use diagrams to explain how an increase in investment in a small open economy with perfect capital mobility will affect savings, net exports, and the real exchange rate.
 7. A) Draw a diagram with a Long Run Phillips Curve and a Short Run Phillips Curve when expected inflation is 0%.
B) Explain what will change in your diagram if the expected rate of inflation increases to 10%.
 8. The Bank of Canada currently targets a 2% rate of inflation. Explain one benefit, and one cost, of the Bank targeting a lower rate of inflation.
 9. A) Explain what is meant by the "Neutrality of Money".
B) If money is neutral, what will be the effect of an increase in the growth rate of the money supply on: inflation, the real interest rate, and the nominal interest rate?

PART C.

Long Answer. Use the extra booklet. Answer ANY ONE question. 20 marks.

1. Canada is a small open economy with a flexible exchange rate and perfect capital mobility. Suppose the Bank of Canada decreases the money supply. With the aid of diagrams, explain how this will affect the rate of interest, the exchange rate, output, and the price level, first in the short run and then in the long run.
2. Does a \$10 billion increase in government spending in a closed economy cause a \$10 billion decrease in private spending on consumption and investment (crowding out)? Explain with the aid of diagrams, both for the short run and for the long run.
3. A) Under what circumstances should the government use fiscal and or monetary policy to stabilize the economy? Explain with the aid of AD and AS curves.
B) Discuss the advantages and disadvantages of using fiscal and monetary stabilization policy.

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PART A. MULTIPLE CHOICE ANSWER SHEET

NAME _____
[SURNAME, GIVEN NAME]
STUDENT NUMBER _____

USE UPPER CASE LETTERS TO ANSWER.

1. _____
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4. _____
5. _____
6. _____
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