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CARLETON UNIVERSITY

Final EXAMINATION APRIL 2010

DURATION: 2.5 HOURS**No. of Students: 1360**

Department Name & Course Number: ECON 1000/1002 A, B, C, D, V
Course Instructor(s): N. Rowe, G. Kowalski, V. Dehejia, 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 immediately to a proctor. This question paper has 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 exam booklet. (Total 40 Marks)

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

Please note: Answer Parts B & C in separate exam booklets.

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ECON1000Final2010**Multiple Choice**

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

1. A movie company makes 500,000 DVDs of one of its latest releases. It sells 300,000 of them before the end of the second quarter, and holds the others in its warehouse.
 - a. The DVDs will be counted as a change in inventory in the second quarter and so will be included in second-quarter GDP.
 - b. Since the DVDs were not purchased this quarter, they will be counted as an increase in third-quarter GDP.
 - c. Since the DVDs will eventually be bought by consumers, they are included as consumption in the second quarter.
 - d. The DVDs will be counted as a change in inventory in the second quarter, and when sold in the third quarter will raise GDP.
2. Suppose that in a closed economy GDP is equal to 12,000, Taxes are equal to 1,500, Consumption equals 6,800, and Government expenditures equal 2,500. What is national saving?
 - a. 4,200
 - b. 2,700
 - c. 1,200
 - d. 1,000
 - e. 500
3. A higher interest rate induces people to
 - a. save more, so the supply of loanable funds slopes upward.
 - b. save less, so the supply of loanable funds slopes downward.
 - c. invest more, so the supply of loanable funds slopes upward.
 - d. invest less, so the supply of loanable funds slopes downward.
4. In 1995, MP Bill Gatt proposed that the income tax be replaced with a consumption tax. If his program had been passed, then today it is likely that the equilibrium interest rate
 - a. and quantity of loanable funds would be lower.
 - b. and quantity of loanable funds would be higher.
 - c. would be higher and the equilibrium quantity of loanable funds would be lower.
 - d. would be lower and the equilibrium quantity of loanable funds would be higher.
5. Fiat currency
 - a. has no intrinsic value.
 - b. is backed by gold.
 - c. has intrinsic value equal to its value in exchange.
 - d. is any close substitute for currency such as checkable deposits.
6. To decrease the money supply, Bank of Canada could
 - a. sell government bonds.
 - b. increase the overnight rate.
 - c. increase the reserve requirement.
 - d. All of the above are correct.

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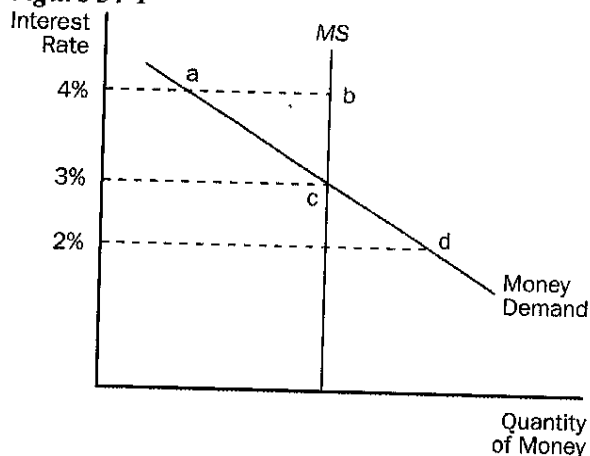
7. If the reserve ratio is 10 percent, banks do not hold excess reserves, and people do not hold currency, then when Bank of Canada purchases \$20 million of government bonds, bank reserves
 - a. increase by \$20 million and the money supply eventually increases by \$200 million.
 - b. decrease by \$20 million and the money supply eventually increases by \$200 million.
 - c. increase by \$20 million and the money supply eventually decreases by \$200 million.
 - d. decrease by \$20 million and the money supply eventually decreases by \$200 million.
8. Open-market purchases by Bank of Canada make the money supply
 - a. and the value of money increase.
 - b. increase, which makes the value of money decrease.
 - c. and the value of money decrease.
 - d. decrease, which makes the value of money increase.
9. A Japanese firm buys lumber from Canada and pays for it with yen. Other things the same, Japanese
 - a. net exports increase, and Canadian net capital outflow increases.
 - b. net exports increase, and Canadian net capital outflow decreases.
 - c. net exports decrease, and Canadian net capital outflow increases.
 - d. net exports decrease, and Canadian net capital outflow decreases.
10. In the open-economy macroeconomic model, the market for loanable funds identity can be written as
 - a. $S = I$
 - b. $S = NCO$
 - c. $S = I + NCO$
 - d. $S + I = NCO$
 - e. $S = NX$
11. Which of the following would tend to shift the supply of dollars in foreign-currency exchange market of the open-economy macroeconomic model to the left?
 - a. The exchange rate rises.
 - b. The exchange rate falls.
 - c. The expected rate of return on Canadian assets rises.
 - d. The expected rate of return on Canadian assets falls.
 - e. None of the above are correct.
12. The real exchange rate equals the relative
 - a. price of domestic and foreign currency.
 - b. price of domestic and foreign goods.
 - c. rate of domestic and foreign interest.
 - d. None of the above is correct.
13. The aggregate quantity of goods demanded increases if
 - a. real wealth rises.
 - b. the interest rate rises.
 - c. the dollar appreciates.
 - d. All of the above are correct.

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14. Suppose a shift in aggregate demand creates an economic contraction. If policymakers can respond with sufficient speed and precision, they can offset the initial shift by shifting
- aggregate supply right.
 - aggregate supply left.
 - aggregate demand right.
 - aggregate demand left.

For the following questions, consult the diagram below:

Figure 34-1



15. Refer to Figure 34-1. If the current interest rate is 2 percent,
- there is excess money supply.
 - people will sell more bonds, which drives interest rates up.
 - as the money market moves to equilibrium, people will buy more goods.
 - All of the above are correct.
16. Refer to Figure 34-1. Which of the following shifts money demand to the right?
- an increase in the price level
 - a decrease in the price level
 - an increase in the interest rate
 - a decrease in the interest rate
17. In a small open economy with a flexible exchange rate, an expansionary fiscal policy causes
- the dollar to depreciate.
 - the dollar to appreciate
 - net exports to increase.
 - has a lasting effect on aggregate demand.
 - None of the above is correct.
18. To move to a point on the Phillips curve where unemployment is lower,
- inflation must fall.
 - the government could cut taxes.
 - the Bank of Canada could decrease the money supply.
 - None of the above is correct.

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19. Ultimately, the short-run reduction in unemployment associated with an increase in inflation is due to
 - a. the shape of the long-run aggregate supply curve.
 - b. unanticipated inflation, not inflation per se.
 - c. rational expectations.
 - d. anticipated changes in the price level.

20. The economy goes into recession. Which of the following lists contains things policymakers could do to try to end the recession?
 - a. increase the money supply, increase taxes, increase government spending
 - b. increase the money supply, increase taxes, decrease government spending
 - c. increase the money supply, decrease taxes, increase government spending
 - d. decrease the money supply, increase taxes, decrease government spending

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Part A Short Answer Questions**Answer ANY FIVE Questions 8 marks each (Use your main booklet)**

1. Consider a small country that only produces two goods: milk and honey. The following table shows the quantity produced for each of the goods in the years 2004, 2005 and 2006. The prices in each of the three years are also included.

Year	Price of Milk (per litre)	Quantity of milk (litres)	Price of honey (per litre)	Quantity of honey (litres)
2004	\$1	100	\$2	50
2005	\$1	200	\$2	100
2006	\$2	200	\$4	100

- a) Compute nominal GDP, real GDP and the GDP deflator for each year, using 2004 as the base year.
 - b) Did economic well-being rise more in 2005 or 2006? Explain.
2. Explain the difference between: search theory of unemployment; efficiency wage theories of unemployment.
3. a) Draw a diagram showing the long run aggregate supply curve and short run aggregate supply curve
 b) What are three theories of the SRAS curve?
 c) Explain how an increase in the expected price level will affect the SRAS curve?
4. In a recession, why might policy-makers choose to use monetary and/or fiscal policy rather than let the economy adjust on its own? Use diagrams to illustrate your answer.
5. Suppose that the Bank of Canada suddenly decides to target 4% inflation rather than 2% inflation. What will happen to unemployment in the short run? What will happen to unemployment in the long run? Use a Phillips curve diagram to illustrate your answer.
6. a) Explain why banks can influence the money supply if the required reserve ratio is less than 100 percent.
 b) Draw a simple T-account for the First National Bank of Ontario, which has \$5,000 of deposits, a reserve ratio of 10 percent, and excess reserves of \$300.
 c) If the reserve ratio is 20 percent, how much money can be created from \$1000 of reserves? Show your work.
7. a) Explain what is meant by the Neutrality of Money.
 b) Is money likely to be neutral in the long run? Why?
 c) Is money likely to be neutral in the short run? Why?
8. Explain what is meant by the following, and how they affect the supply of money:
 a) Open market operations
 b) Foreign exchange market operations
 c) Sterilization
9. a) Explain what is meant by "diminishing returns to capital"

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b) If there is a permanent increase in the rate of savings and investment, will this cause a permanent increase in the growth rate of output? Explain.

PART C: Long Answer Questions Answer ANY ONE question. 20 marks. Use the extra booklet.

1.
 - a) Assume that Canada is a small open economy. Explain, with the aid of diagrams, how a fall in world interest rates would affect Canadian national savings, the rate of interest, investment, the real exchange rate, net capital outflows, and net exports, in the long run.
 - b) Using the same open economy model, and with the aid of diagrams, explain how the recent change in Canadian government policy (i.e., the shift from a budget surplus to a budget deficit) could be expected to affect Canadian national savings, the rate of interest, investment, net capital outflow, the real exchange rate, and net exports, in the long run.
2. What would be the effects on the Canadian economy if the Bank of Canada decreased the money supply? Assume that Canada is a small open economy with perfect capital mobility and a flexible exchange rate. Explain how this would affect the interest rate, the demand for money, aggregate demand, the exchange rate, net exports, output, and employment, first in the short run, and then in the long run? Illustrate your answer with diagrams.
3. Assume a closed economy. Suppose the government changes the tax laws to give firms an incentive to increase investment. With the aid of diagrams:
 - a) Explain how this would affect Aggregate Demand
 - b) Explain how this would affect Aggregate Supply.
 - c) Explain how this would affect the price level, and real GDP, in the short run.
 - d) Explain how this would affect the price level and real GDP, in the long run.