CARLETON UNIVERSITY

FINAL
EXAMINATION
April 2012

DURATION: 2.5 HOURS No. of Students: 1445

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

Course Instructor(s): N. Rowe, C. Kyeremeh, 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 NINE (9) **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)

Please note: Answer parts B & C in separate exam booklets!

<u>Part A: Multiple Choice. USE ANSWER SHEET PROVIDED</u>

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

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1.How is NNP calculated?

a. by subtracting saving from the total income of citizens of a nation
b. by subtracting business expenses and taxes from the total profits earned by citizens of a nation
c. by subtracting depreciation from the total income of citizens of a nation
d. by subtracting depreciation from the total profits earned by citizens of a nation

2. If the prices of Australian-made shoes imported into Canada increase, what happens to the Canadian GDP deflator and the Canadian consumer price index?

a. Both the GDP deflator and the consumer price index will increase.
b. Neither the GDP deflator nor the consumer price index will increase.
c. The GDP deflator will increase, but the consumer price index will not increase.
d. The consumer price index will increase, but the GDP deflator will not increase.

3. In a closed economy, what does ($T – G$) represent?

a. national saving
b. investment
c. private saving
d. public saving

4. Suppose a poor country decides to institute an investment tax credit. As a result, which of the following is most likely to happen?

a. Interest rates would rise, and investment would fall.
b. Interest rates would fall, and investment would rise.
c. Both interest rates and investment would fall.
d. Both interest rates and investment would rise.

5. Which of the following people would be included in the labour force?
a. Derrick, who is waiting for his new job to start
b. Brett, who has become discouraged looking for a job and has quit looking for a while
c. Homer, an unpaid homemaker
d. A 20-year-old student who does not work and is not looking for work

6.What impact would an increase in the minimum wage have on the quantity demanded and quantity supplied of labour?

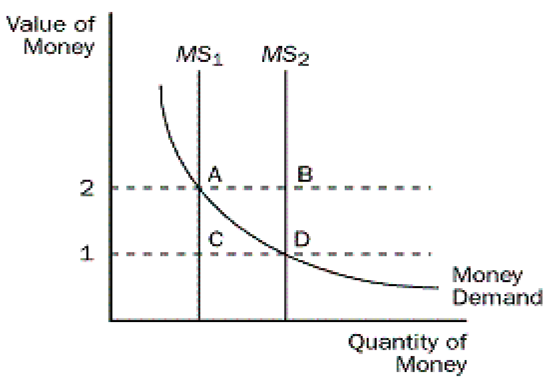
a. It would increase both the quantity demanded and the quantity supplied of labour.
b. It would decrease both the quantity demanded and the quantity supplied of labour.
c. It would increase the quantity of labour demanded while decreasing the quantity supplied.
d. It would decrease the quantity of labour demanded while increasing the quantity supplied.

7. How could the Bank of Canada increase the money supply?

a. sell government bonds
b. decrease the overnight rate
c. increase the reserve requirement
d. increase the overnight rate

Use the figure below for the following questions.

Figure 30-1



8. **Refer to Figure 30-1**. What happens when the money supply curve shifts from MS_1 to MS_2?

a. The demand for goods and services decreases.
b. The economy's ability to produce goods and services decreases.
c. The equilibrium price level increases.
d. The equilibrium value of money increases.

Next page….

9. What does the principle of monetary neutrality imply?

   a. An increase in the money supply will increase real GDP and the price level.
   b. An increase in the money supply will increase real GDP, but not the price level.
   c. An increase in the money supply will increase the price level, but not real GDP.
   d. An increase in the money supply will increase neither the price level nor real GDP.

10. If velocity and output were nearly constant, how would the inflation rate compare with the money supply growth rate?

    a. The inflation rate would be much higher than the money supply growth rate.
    b. The inflation rate would be about the same as the money supply growth rate.
    c. The inflation rate would be much lower than the money supply growth rate.
    d. The inflation rate cannot be compared with the money supply growth rate because they are independent of each other.

11. Inflation is positively correlated with which of the following?

    a. nominal wage growth and nominal interest rates
    b. neither nominal wage growth nor nominal interest rates
    c. nominal wage growth, but not nominal interest rates
    d. the nominal interest rate, but not nominal wage growth

12. Which of the following is the formula for saving in an open economy?

    a. Saving = Foreign saving + Net capital outflow
    b. Saving = Domestic investment – Net capital outflow
    c. Saving = Domestic saving + Net capital outflow
    d. Saving = Domestic investment + Net capital outflow

13. Suppose Canada imposes an import quota on steel. Which of the following describes the most likely effects of this quota?

    a. Canadian exports would increase, the real exchange rate of the Canadian dollar would appreciate, and Canadian net capital outflow would increase.
    b. Canadian exports would increase, the real exchange rate of the Canadian dollar would depreciate, and Canadian net capital outflow would remain unchanged.
    c. Canadian exports would decrease, the real exchange rate of the Canadian dollar would appreciate, and Canadian net capital outflow would remain unchanged.
    d. Canadian exports would decrease, the real exchange rate of the Canadian dollar would depreciate, and Canadian net capital outflow would decrease.

14. Which of the following happens during recessions?

   a. Firms produce less but invest more.
   b. Firms have to increase production because of falling prices.
   c. Incomes increase because workers have to work overtime.
   d. Many workers are laid off.

15. Which of the following shifts aggregate demand to the left?

   a. an increase in the price level
   b. a decrease in the money supply
   c. an increase in net exports
   d. an investment tax credit

16. If at some interest rate the quantity of money demanded is greater than the quantity of money supplied, what will people desire to do and what will happen to the interest rate?

   a. People will sell interest-bearing assets, causing the interest rate to decrease.
   b. People will sell interest-bearing assets, causing the interest rate to increase.
   c. People will buy interest-bearing assets, causing the interest rate to decrease.
   d. People will buy interest-bearing assets, causing the interest rate to increase.

17. According to the theory of liquidity preference, what does a decrease in the price level cause the interest rate and investment to do?

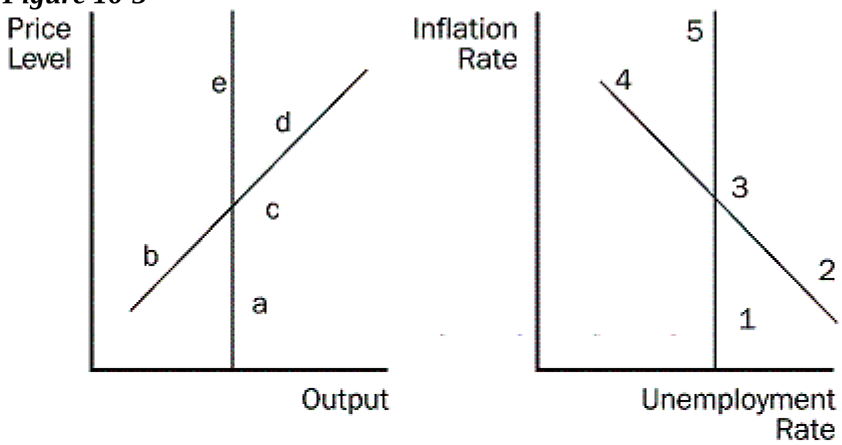
   a. It causes both the interest rate and investment to rise.
   b. It causes both the interest rate and investment to fall.
   c. It causes the interest rate to rise and investment to fall.
   d. It causes the interest rate to fall and investment to rise.

18. Economists agree on all of the following statements **EXCEPT** which one?

   a. Increases in the money supply shift aggregate demand to the right.
   b. In the long run, increases in the money supply increase prices, but not output.
   c. Recessions are associated with decreases in consumption, investment, and employment.
   d. Government should use fiscal policy to try and stabilize the economy.

Use the two graphs in the diagram to answer the following questions.

Figure 16-3



19. **Refer to Figure 16-3**. Where does a decrease in aggregate demand move the economy from *c* and 3 to, in the short run and the long run?

a. *a* and 1 in the short run, *b* and 2 in the long run
b. *b* and 2 in the short run, *a* and 1 in the long run
c. *d* and 4 in the short run, *e* and 5 in the long run
d. *b* and 4 in the short run, *e* and 1 in the long run

20. Suppose that the central bank must follow a rule that requires it to increase the money supply when the price level falls and decrease the money supply when the price level rises. If the economy starts from long-run equilibrium and aggregate demand shifts right, what must the central bank do, and what will happen to output?

a. The central bank must decrease the money supply, which will move output back towards its long-run level.
b. The central bank must decrease the money supply, which will move output farther from its long-run level.
c. The central bank must increase the money supply, which will move output back towards its long-run level.
d. The central bank must increase the money supply, which will move output farther from its long-run level.

Part B on next page…

Part B Short Answer. USE THE MAIN BOOKLET.

Answer ANY 5 of the following questions. 8 marks each.

1. a. How does the Consumer Price Index differ from the GDP deflator?
   b. Explain what is meant by the "substitution bias" in the CPI.
   c. If food prices increased by 10%, and movie ticket prices decreased by 10%, and all other prices stayed the same, would the CPI increase or decrease? Explain.

2. a. What are the long run benefits of increased saving and investment?
   b. What are the opportunity costs of increased saving and investment?
   c. How will increased saving and investment affect consumption, in the short run, and in the long run?

3. Explain the difference between these two theories of unemployment: Search Theory; Efficiency Wage Theory.

4. a. Write down an equation to describe the relation between the money supply M, the velocity of circulation V, the price level P, and real income Y.
   b. If real GDP is growing at 3% per year, and velocity of circulation is constant, and the Bank of Canada wants 2% annual inflation, what must the Bank of Canada do with the money supply?
   c. If inflation increased to 100% per year, what would probably happen to velocity? Explain.

5. According to Purchasing Power Parity (PPP):
   a. If a dozen eggs cost $2.50 in Canada, and 10 shillings in Kenya, what would be the exchange rate between the Kenyan shilling and the Canadian dollar (how many Kenyan shillings would you get for one Canadian dollar?)
   b. What is the mechanism that would tend to make PPP approximately true for some goods?
   c. What could prevent PPP being exactly true for some other goods?

6. Suppose that Canadians decide to save a bigger proportion of their incomes. If Canada is a small open economy, use two diagrams to show how this will affect: Canadian investment; Net capital Outflow; the real exchange rate; and net exports.

7. a. Draw a diagram showing the Long Run Phillips Curve and Short Run Phillips Curve.
   b. What happens on your diagram if the actual inflation rate increases to 10% but the expected inflation rate stays at 2%?
   c. What happens on your diagram if the expected rate of inflation then increases to 10% too?
   d. What happens on your diagram if the natural rate of unemployment increases?

8. a. Explain the relation between the Multiplier Effect and the effect of an increase in government spending on the Aggregate Demand curve.
   b. Explain the relation between the Multiplier Effect and the Marginal Propensity to Consume.

PART C Long Answer. USE THE EXTRA BOOKLET.

Answer ANY ONE question. 20 marks

1. Canada is a small open economy. Explain, with the aid of diagrams, the effects of an increase in government spending on Aggregate Demand, real income, the rate of interest, the exchange rate, and net exports.
   a. First, assuming flexible exchange rates.
   b. Second, assuming fixed exchange rates.

2. The Bank of Canada currently targets 2% inflation. Would it be a good idea or a bad idea for the Bank of Canada to target 10% inflation instead?
   a. Explain the effects of this change on: the growth rate of the money supply; nominal and real interest rates; nominal and real income.
   b. Explain the effects on creditors and debtors.
   c. Explain the costs and/or benefits of this increase in the inflation rate.

3. Draw a diagram showing the Aggregate Demand curve, Long Run Aggregate Supply curve, and Short Run Aggregate Supply curve.
   a. Explain one theory why the SRAS curve has a different slope to the LRAS curve.
   b. Use this diagram to explain why governments might wish to use monetary and/or fiscal policy for macroeconomic stabilization.
   c. Explain some of the difficulties of using monetary and/or fiscal policy for macroeconomic stabilization.