

**THE UNIVERSITY OF WESTERN ONTARIO  
LONDON CANADA**

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**ECONOMICS 1022B-002/004**

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**MIDTERM 2**

**INSTRUCTIONS:**

1. The examination begins at **4:00 p.m.** and ends at **6:00 p.m.**
2. Check that your examination paper contains 19 pages.
3. Use a **BLACK PENCIL** to complete your Scantron Form.

Print your **NAME** and complete your **SIGNATURE**.

Enter your **STUDENT NUMBER**.

Enter your **SECTION NUMBER**, which is either 002 or 004.

4. **Please hand in Scantron Form only.**
5. You may use a regular calculator but you may not use a programmable or graphing calculator. Your cell phone may *not* be used as a calculator.
6. Your cell phone must be switched off and left in your bag at the front of the exam room.
7. You must remain in the examination room until you have finished the exam. No breaks outside of the examination room will be allowed.

**NOTE: QUESTIONS ARE PRINTED ON BOTH SIDES OF EACH PAGE**

Use the figure below to answer the following question.

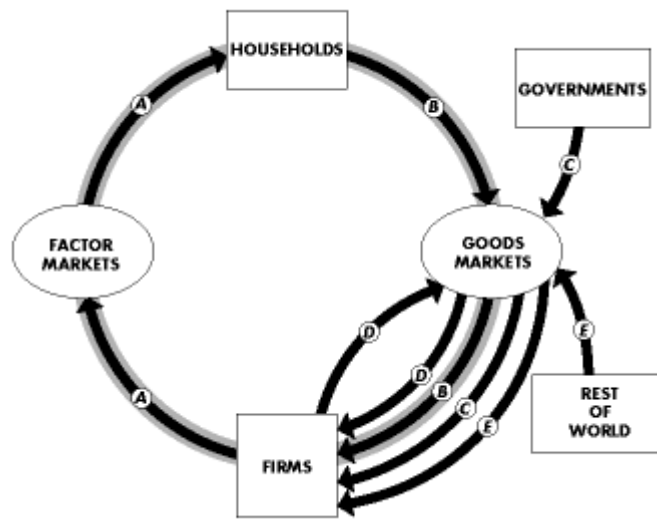


Figure 1

- 1) Refer to Figure 1, which shows the circular flow of expenditure and income for Venus. During 2008, *A* was \$100, *B* was \$50, *C* was \$30 and *D* was \$10. How much is net exports?
- A) \$10.
  - B) \$25.
  - C) \$30.
  - D) \$50.
  - E) None of the above.

Use the table below to answer the following question.

**Table 1**

|  |        |
|--|--------|
| Government expenditures on goods and services    | \$ 500 |
| Wages, salaries, and supplementary labour income | 2,000  |
| Depreciation                                     | 400    |
| Investment                                       | 400    |
| Consumption expenditure                          | 2,200  |
| Net exports                                      | -50    |
| Indirect taxes                                   | 150    |
| Statistical discrepancy                          | 0      |

- 2) Refer to Table 1. Gross domestic product equals
- A) \$3,400.
  - B) \$5,050.
  - C) \$5,600.
  - D) \$3,150.
  - E) \$3,050.
- 3) Why is the Human Development Index thought to be a better measure of economic well-being than real GDP per person?
- A) It includes health and education measures, as well as real GDP per person.
  - B) It includes only health and education measures, ignoring real GDP per person.
  - C) It includes a measure of resource depletion.
  - D) It includes leisure time and household production.
  - E) It ignores health, which is hard to measure.
- 4) In a country with a working-age population of 22 million, 16 million are employed, 2 million are unemployed, and 1 million of the employed are working part-time, half of whom wish to work full-time. The involuntary part-time rate is
- A) 5 percent.
  - B) 6.3 percent.
  - C) 12.5 percent.
  - D) 2.8 percent.
  - E) none of the above.
- 5) Counting discouraged workers as unemployed would
- A) lower the measured unemployment rate.
  - B) raise the measured unemployment rate.
  - C) raise the natural unemployment rate.
  - D) not change the measured unemployment rate.
  - E) raise the full employment rate.

- 6) The reference base period is 2002. A consumer price index of 122 in 2009 means that
- A) the average of the prices paid by urban consumers for a fixed market basket of consumer goods and services was 22 percent higher in 2009 than it was on average during 2002.
  - B) if the price of a good was \$100 in 2002, its price in 2009 is \$122.
  - C) the market basket of consumer goods that cost \$122 in 2002 can be purchased for \$100 in 2009.
  - D) prices of consumer goods have gone up by a factor of 12.2.
  - E) prices of consumer goods have more than doubled.

Use the table below to answer the following question.

**Table 2**  
Data From Southton

| Item         | Price     | Price     | Quantity | Quantity |
|--------------|-----------|-----------|----------|----------|
|              | (dollars) | (dollars) | (number) | (number) |
|              | Base      | Current   | Base     | Current  |
| Rubber       |           |           |          |          |
| Ducks        | 1.00      | 1.25      | 100      | 100      |
| Beach Towels | 9.00      | 6.00      | 12       | 14       |

- 7) Refer to Table 2. From the data in Table 2, what is Southton's consumer price index for the current year?
- A) 112
  - B) 94.7
  - C) 100.5
  - D) 100
  - E) 105.6
- 8) Suppose a country is producing \$20 million of real GDP. If the economy grows at 10 percent per year, approximately how many years will it take for real GDP to grow to \$80 million?
- A) 30
  - B) 3.5 years
  - C) 7
  - D) 4
  - E) 14
- 9) Which of the following statements about Canada's long-term growth trends is *false*?
- A) Economic growth rates show periods of slow and high growth.
  - B) Economic growth rates have generally been faster in Japan than in Canada.
  - C) African countries have fallen further behind Canada in recent years.
  - D) Economic growth rates have been steady, except for the business cycle.
  - E) Economic growth rates were faster in the 1990s than in the 1980s.

- 10) *Ceteris paribus*, an increase in population results in a
- A) higher level of labour employed and higher potential GDP per hour of labour.
  - B) constant level of labour employed and constant potential GDP per hour of labour.
  - C) lower level of labour employed and lower potential GDP per hour of labour.
  - D) lower level of labour employed and higher potential GDP per hour of labour.
  - E) higher level of labour employed and lower potential GDP per hour of labour.
- 11) An increase in population results in
- A) a leftward shift of the labour supply curve.
  - B) a movement along the production function.
  - C) an upward shift in the production function.
  - D) a rightward shift of the labour demand curve.
  - E) both B and D are correct.
- 12) A decrease in the real interest rate leads to a \_\_\_\_\_ the demand for loanable funds curve, and a decrease in expected profit leads to a \_\_\_\_\_ the demand for loanable funds curve.
- A) rightward shift of; movement up along
  - B) movement down along; rightward shift of
  - C) movement down along; movement up along
  - D) rightward shift of; leftward shift of
  - E) movement down along; leftward shift of
- 13) A government budget deficit \_\_\_\_\_ the demand for loanable funds, \_\_\_\_\_ the real interest rate, and \_\_\_\_\_ investment.
- A) decreases; increases; increases
  - B) increases; decreases; increases
  - C) increases; increases; crowds out
  - D) decreases; increases; crowds out
  - E) increases; decreases; crowds out

Refer to the table below to answer the following question.

**Table 3**

| Real interest rate<br>(percent per year) | Loanable funds demanded<br>(trillions of 2002 dollars) | Loanable funds supplied<br>(trillions of 2002 dollars) |
|--|--|--|
| 4  | 8.5  | 5.5  |
| 5  | 8.0  | 6.0  |
| 6  | 7.5  | 6.5  |
| 7  | 7.0  | 7.0  |
| 8  | 6.5  | 7.5  |
| 9  | 6.0  | 8.0  |
| 10                                       | 5.5  | 8.5  |

- 14) Refer to Table 3. The table shows an economy's demand for loanable funds and supply of loanable funds schedules when the government's budget is balanced. The quantity of loanable funds demanded increases by \$1 trillion at each real interest rate and the quantity of loanable funds supplied increases by \$2 trillion at each real interest rate. If the government wants investment to be \$9 trillion, it must \_\_\_\_\_ its budget balance by \_\_\_\_\_ trillion.
- A) increase; \$1
  - B) increase; \$1.5
  - C) increase; \$2
  - D) decrease; \$1
  - E) decrease; \$1.5
- 15) Which one of the following is a component of M2 but not of M1?
- A) Currency outside banks.
  - B) Personal chequable deposits.
  - C) Canada Savings Bonds.
  - D) Currency in a bank vault.
  - E) Personal non-chequable deposits.
- 16) Suppose that a country has \$50 billion in bank reserves, \$100 billion in currency held by the public, and \$500 billion in bank deposits. The currency drain ratio is
- A) 20%.
  - B) 50%.
  - C) 18%.
  - D) 30%.
  - E) 10%.

- 17) Quantecon is a country in which the quantity theory of money operates. The country has a constant population, capital stock, and technology. In year 1, real GDP was \$400 million, the price level was 200, and the velocity of circulation was 20.  
In year 2 the quantity of money was 20 percent higher than in year 1.  
The quantity of money in year 1 was \_\_\_\_\_.  
The quantity of money in year 2 was \_\_\_\_\_.  
The price level in year 2 is \_\_\_\_\_.
- A) \$80 million; \$88 million; 200
  - B) \$20 million; 24 million; 240
  - C) \$20 million; \$24 million; 220
  - D) \$40 million; \$48 million; 240
  - E) \$40 million; \$48 million; 220
- 18) Suppose that the Canadian dollar exchanges for 0.90 U.S. dollars and also for 0.65 Euros. A U.S. dollar exchanges for
- A) 1.39 Euros.
  - B) 0.25 Euros.
  - C) 1.55 Euros.
  - D) 1.00 Euro.
  - E) 0.72 Euros.
- 19) Choose the incorrect statement.
- A) In the CERI, each currency gets a weight that represents the importance of the currency in Canada's international trade.
  - B) The nominal CERI and the real CERI appreciated constantly between 1997 and 2008.
  - C) The CERI shows that the dollar depreciated on average from 1997-2002 and then appreciated through 2007.
  - D) The absence of a gap between the real CERI and the nominal CERI between 1997 and 2008 results from the fact that the inflation rates in Canada and the other countries were similar.
  - E) The average of the exchange rates of the Canadian dollar against the U.S. dollar, the European Union euro, the Japanese yen, the U.K. pound, the Chinese yuan, and the Mexican peso is the Canadian-dollar effective exchange rate index.
- 20) Which of the following factors influence the demand for Canadian dollars?
- A) The exchange rate and the world demand for Canadian exports.
  - B) Interest rates in Canada and other countries, and the expected future exchange rate.
  - C) The world demand for Canadian exports and Canadian demand for imports.
  - D) Both A and B.
  - E) Both B and C.

- 21) Suppose that people expect that the Canadian exchange rate will decrease in the near future. How will this situation affect the Canadian exchange rate?
- A) The supply of Canadian dollars decreases, the demand for Canadian dollars decreases and the exchange rate falls.
  - B) The supply of Canadian dollars decreases, the demand for Canadian dollars increases and the exchange rate rises.
  - C) Neither the supply of Canadian dollars nor the demand for Canadian dollars changes.
  - D) The supply of Canadian dollars increases, the demand for Canadian dollars decreases and the exchange rate rises.
  - E) The supply of Canadian dollars increases, the demand for Canadian dollars decreases and the exchange rate falls.
- 22) Suppose the exchange rate between the Canadian dollar and the British pound is 0.5 pounds per dollar. If a radio sells for 38 pounds in Britain and purchasing power parity holds, what is the dollar price of the radio?
- A) \$38
  - B) \$26
  - C) \$76
  - D) \$57
  - E) \$19

*Use the information below to answer the following question.*

**Fact 1**

You are given the following information about the country of Ecoland, whose currency is the turkey, and whose official settlements balance is zero.

| Variable                                     | Billions of turkies |
|--|---------------------|
| Real GDP                                     | 50                  |
| Consumption expenditure                      | 30                  |
| Government expenditure on goods and services | 12                  |
| Investment                                   | 11                  |
| Exports                                      | 10                  |
| Government budget deficit                    | 2                   |

- 23) Refer to Fact 1. What is the net exports?
- A) -2 billion turkies
  - B) 3 billion turkies
  - C) -1 billion turkies
  - D) -3 billion turkies
  - E) 1 billion turkies

Use the table below to answer the following question.

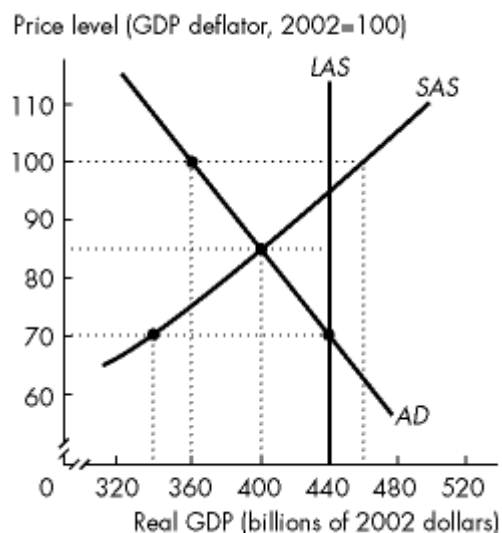
**Table 4**

| Year | Borrowed from Rest of World<br>(billions of dollars) | Loaned to Rest of World<br>(billions of dollars) |
|------|--|--|
| 1    | 60   | 20   |
| 2    | 60   | 40   |
| 3    | 60   | 60   |
| 4    | 60   | 80   |

- 24) Refer to Table 4. If Mengia's official settlement balance was zero every year, for which year or years can you say for sure there was a current account surplus?
- A) year 4 only
  - B) year 2 only
  - C) years 2 and 3
  - D) years 1 and 2
  - E) years 3 and 4
- 25) Which of the following does not change short-run aggregate supply?
- A) A change in expected future profits.
  - B) A change in the full-employment quantity of labour.
  - C) A change in the money wage rate.
  - D) An increase in the quantity of capital.
  - E) Technological change.
- 26) An increase in oil prices to a country that is a net importer of oil shifts
- A) both the short-run aggregate supply and long-run aggregate supply curves leftward.
  - B) both the short-run aggregate supply and long-run aggregate supply curves rightward.
  - C) the short-run aggregate supply curve leftward, but leaves the long-run aggregate supply curve unchanged.
  - D) the short-run aggregate supply curve leftward, but shifts the long-run aggregate supply curve rightward.
  - E) the long-run aggregate supply curve rightward, but leaves the short-run aggregate supply curve unchanged.

- 27) Which of the following situations illustrates how fiscal policy can influence aggregate demand?
- A) The exchange rate value of the Canadian dollar rises. As a result, people living near the US-Canada border increase their imports of goods and net exports decrease.
  - B) Investors, anticipating an erosion of financial wealth due to inflation, decide to save more. As a result, aggregate demand decreases.
  - C) The Bank of Canada raises interest rates so people plan to buy less consumer durables. As a result, the aggregate demand curve shifts leftward.
  - D) The government reduces the goods and services tax. As a result, consumption expenditure increases and aggregate demand increases.
  - E) Both A and C are examples of fiscal policy.
- 28) Everything else remaining the same, an increase in the expected inflation rate
- A) shifts the short-run aggregate supply curve leftward.
  - B) shifts the aggregate demand curve rightward.
  - C) shifts the aggregate demand curve leftward.
  - D) creates a movement up along the aggregate demand curve.
  - E) shifts the long-run aggregate supply curve rightward.

Use the figure below to answer the following question.



**Figure 2**

- 29) Refer to Figure 2. If Econoworld automatically adjusts to a long-run equilibrium, then in the long-run macroeconomic equilibrium
- A) the price level is 70.
  - B) real GDP is \$440 billion.
  - C) potential GDP is greater than in the short run.
  - D) actual unemployment exceeds the natural unemployment rate.
  - E) both A and B.

- 30) If real GDP is greater than potential GDP, the economy is
- A) in long-run equilibrium.
  - B) not in short-run equilibrium.
  - C) in an above full-employment equilibrium.
  - D) in a below full-employment equilibrium.
  - E) in a recessionary equilibrium.

Use the table below to answer the following question.

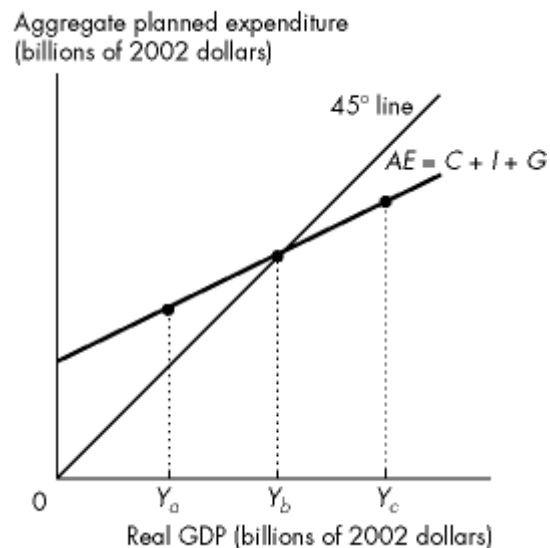
**Table 5**

| Price Level<br>(2002=100) | Aggregate Demand<br>(billions of 2002 dollars) | Short-Run<br>Aggregate Supply<br>(billions of 2002 dollars) | Long-Run<br>Aggregate Supply<br>(billions of 2002 dollars) |
|---------------------------|--|---|--|
| 100                       | 800  | 300   | 600  |
| 110                       | 700  | 400   | 600  |
| 120                       | 600  | 500   | 600  |
| 130                       | 500  | 600   | 600  |
| 140                       | 400  | 700   | 600  |

- 31) Refer to Table 5. Consider the economy represented in the table. There is
- A) neither an inflationary nor a recessionary gap because the economy is at full employment.
  - B) a recessionary gap equal to \$50 billion.
  - C) an inflationary gap equal to \$100 billion.
  - D) a recessionary gap equal to \$100 billion.
  - E) an inflationary gap equal to \$50 billion.
- 32) Which of the following statements about the Keynesian view of the macroeconomy is *incorrect*?
- A) Technological change is the most significant influence on both aggregate demand and aggregate supply.
  - B) The money wage rate is extremely sticky in the downward direction so there is no automatic mechanism for eliminating a recessionary gap.
  - C) Expectations are based on "animal spirits."
  - D) Expectations are the most significant influence on aggregate demand.
  - E) To achieve and maintain full employment, active help from fiscal policy and monetary policy is required.

- 33) If a household's disposable income increases from \$12,000 to \$22,000 and at the same time its consumption expenditure increases from \$4,000 to \$9,000, then
- the slope of the consumption function is 0.5.
  - the marginal propensity to save over this range is negative.
  - the slope of the consumption function is 0.6.
  - the marginal propensity to consume over this range is negative.
  - the household is dissaving.
- 34) When the consumption function lies below the 45° line, households
- are dissaving.
  - consume more than their disposable income.
  - save all of any increase in disposable income.
  - spend all of any increase in disposable income.
  - are saving some portion of their disposable income.

Use the figure below to answer the following question.



**Figure 3**

There are no exports or imports in this economy.

- 35) Refer to Figure 3. When real GDP is equal to  $Y_a$ , then
- planned expenditure is equal to actual expenditure.
  - actual expenditure is greater than planned expenditure.
  - real GDP decreases.
  - the economy is in equilibrium.
  - actual expenditure is less than planned expenditure.

- 36) If  $AE = 50 + 0.6Y$  and  $Y = 200$ , then unplanned inventories
- A) decrease by 30.
  - B) increase by 75.
  - C) increase by 30.
  - D) decrease by 75.
  - E) do not change and equilibrium exists.

Use the table below to answer the following questions.

**Table 6**

The following table shows the relationship between aggregate planned expenditure and GDP in the hypothetical economy of Econoworld.

| Real GDP<br>(billions of 2002<br>dollars) | Aggregate planned<br>expenditure<br>(billions of 2002 dollars) |
|---|--|
| 0   | 100  |
| 200                                       | 260  |
| 400                                       | 420  |
| 600                                       | 580  |
| 800                                       | 740  |

- 37) Refer to Table 6. The equilibrium level of real GDP is
- A) \$550 billion.
  - B) \$525 billion.
  - C) \$450 billion
  - D) \$500 billion
  - E) none of the above.
- 38) Refer to Table 6. The multiplier
- A) is 1.8.
  - B) is 4.
  - C) is 2.5.
  - D) is 5.
  - E) cannot be determined without more information.

- 39) A rise in the price level
- A) decreases aggregate expenditure and produces a movement along the aggregate demand curve.
  - B) decreases aggregate expenditure and produces a leftward shift of the aggregate demand curve.
  - C) increases aggregate expenditure, but has no effect on the aggregate demand curve.
  - D) decreases aggregate expenditure and produces a rightward shift of the aggregate demand curve.
  - E) has no effect on aggregate expenditure.
- 40) Suppose that investment decreases by \$15 billion. The multiplier is 2, and the short-run aggregate supply curve is positively sloped. In the short run, equilibrium real GDP
- A) decreases by less than \$30 billion.
  - B) decreases by \$30 billion.
  - C) decreases by more than \$30 billion.
  - D) does not change.
  - E) increases by less than \$30 billion.

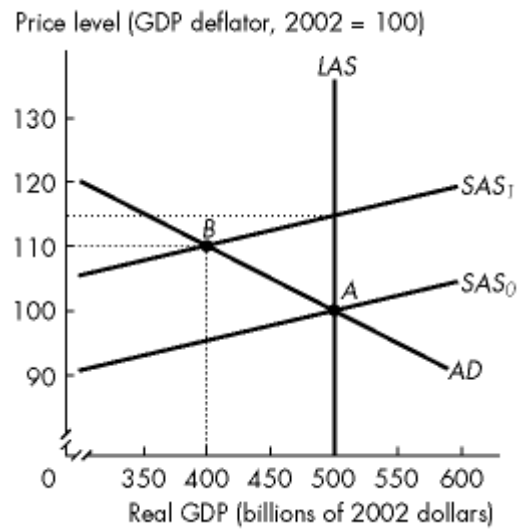
*Use the information below to answer the following question.*

**Fact 2**

The economy of Beverly Hills has a consumption function of  $C = 10 + 0.8Y$ , investment equal to 6, government expenditure equal to 10, exports equal to 10, and an import function of  $M = 0.1Y$ .

- 41) Refer to Fact 2. What is equilibrium real GDP in this economy?
- A) 36
  - B) 360
  - C) 120
  - D) 130
  - E) none of the above
- 42) At full employment an increase in the quantity of money (*ceteris paribus*) can create a
- A) demand-pull and a cost-push inflation, as can an increase in government expenditure.
  - B) demand-pull inflation, but an increase in government expenditure cannot.
  - C) cost-push inflation, but an increase in government expenditure cannot.
  - D) cost-push inflation, as can an increase in government expenditure.
  - E) demand-pull inflation, as can an increase in government expenditure.

Use the figure below to answer the following question.



**Figure 4**

- 43) Refer to Figure 4. The economy is in long-run equilibrium. If the short-run aggregate supply curve shifts leftward from  $SAS_0$  to  $SAS_1$ , *ceteris paribus*, then people expected
- A) a 10 percent inflation.
  - B) the real wage rate to fall by 10 percent.
  - C) the price level to rise to 110.
  - D) a 15 percent inflation.
  - E) a real GDP decrease of \$50 billion.

Use the figure below to answer the following question.



**Figure 5**

- 44) Refer to Figure 5. The figure illustrates an economy initially in equilibrium at point *A*. If the quantity of money is expected to increase by 50 percent, what is the rational expectation of the price level?
- A) 120
  - B) 150
  - C) 100
  - D) 130
  - E) We cannot tell without more information on wage negotiations.

Use the figure below to answer the following question.



**Figure 6**

- 45) Refer to Figure 6. Starting at point *A*, the initial effect of a demand-pull inflation is a move to point \_\_\_\_\_. As a demand-pull inflation spiral proceeds, it follows the path \_\_\_\_\_.
- A) *C; E, H, I*
  - B) *E; I*
  - C) *B; E, G, I*
  - D) *C; B, H, G, I*
  - E) none of the above
- 46) If the natural unemployment rate rises
- A) the short-run and long-run Phillips curves both shift rightward.
  - B) the short-run Phillips curve shifts rightward and the long-run Phillips curve does not change.
  - C) the long-run Phillips curve shifts rightward and the short-run Phillips curve does not change.
  - D) the short-run and long-run Phillips curves both shift leftward.
  - E) the long-run Phillips curve shifts leftward and the short-run Phillips curve does not change.

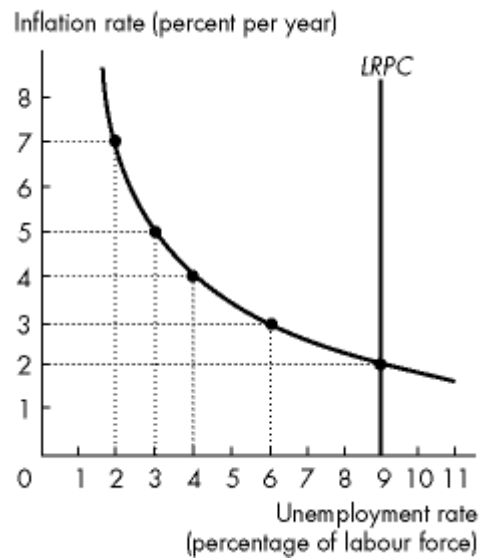
Use the table below to answer the following question.

**Table 7**

| Inflation<br>(percent per<br>year) | Unemployment<br>(percent) |
|------------------------------------|---------------------------|
| 12                                 | 4                         |
| 11                                 | 5                         |
| 10                                 | 6                         |
| 9                                  | 7                         |
| 8                                  | 8                         |
| 7                                  | 9                         |

- 47) Refer to Table 7. The table gives points on the short-run Phillips curve for the country of Ruritania. If the expected inflation rate is 10 percent, and the inflation rate unexpectedly rises to 12 percent and stays there for some period of time, the expected inflation rate becomes \_\_\_\_\_ percent and the natural unemployment rate is \_\_\_\_\_ percent.
- A) 12; 4
  - B) 12; 6
  - C) 12; 5
  - D) 10; 4
  - E) 10; 6

Use the figure below to answer the following question.



**Figure 7**

- 48) Refer to Figure 7. The figure illustrates an economy's Phillips curves. If the current inflation rate is 4 percent, what is the natural unemployment rate?
- A) 3 percent
  - B) 4 percent
  - C) 6 percent
  - D) 9 percent
  - E) cannot be determined without more information
- 49) According to the real business cycle theory, what effects follow from a change in productivity?
- I. Investment demand changes.
  - II. The demand for labour changes.
  - III. Government expenditure changes.
- A) I and II
  - B) I, II and III
  - C) I
  - D) I and III
  - E) II and III

50) Suppose that the business cycle in Canada is best described by RBC theory.

An advance in technology increases productivity.

The when-to-work decision depends on the real interest rate. The \_\_\_\_\_ the real interest rate, other things remaining the same, the \_\_\_\_\_ is the supply of labour today.

RBC theorists believe the when-to-work effect is \_\_\_\_\_.

- A) higher; larger; large
- B) higher; smaller; small
- C) higher; larger; small
- D) lower; smaller; small
- E) lower; larger; large

## Answer Key

Testname: MT2MAR10

- 1) A
- 2) E
- 3) A
- 4) D
- 5) B
- 6) A
- 7) B
- 8) E
- 9) D
- 10) E
- 11) B
- 12) E
- 13) C
- 14) A
- 15) E
- 16) A
- 17) D
- 18) E
- 19) B
- 20) D
- 21) E
- 22) C
- 23) D
- 24) A
- 25) A
- 26) C
- 27) D
- 28) B
- 29) E
- 30) C
- 31) B
- 32) A
- 33) A
- 34) E
- 35) E
- 36) C
- 37) D
- 38) D
- 39) A
- 40) A
- 41) C
- 42) E

## Answer Key

Testname: MT2MAR10

43) D

44) B

45) A

46) A

47) B

48) D

49) A

50) A