

Department of Economics  
 Carleton University  
 ECON 2102H  
 Practice Questions for the final exam

A. Garzoni

Winter 2011

1. Explain why a monetary contraction for a small open economy under fixed exchange rates will have no effect on real income.
2. Given the following information (in million of dollars):

Exports	457
Imports	401
Investment Income Received	35
Investment Income Paid	65
Transfers Received	6
Transfers Paid	5
Purchases of Foreign Assets by Canadians	115
Sales of Canadian Assets by Foreigners	85

- a. Calculate the value of the Current Account.
  - b. Calculate the value of the Capital Account.
3. Explain why the domestic interest rate can be different from the foreign interest rate under imperfect assets substitutability.
4. The following equations describe the economy:
 

Goods market:  $Y = C(Y) + I(r) + G$   
 $C(Y) = 0.8(1-t)Y$   
 $t = 0.25$   
 $I(r) = 900 - 50r$   
 $G_0 = 800$

Money market:  $M/P = L(Y, r)$   
 $L(Y, r) = 0.25Y - 62.5r$   
 $M/P = 500$

  - a) What is the equation of the *IS* curve? What is its slope?
  - b) What is the definition of the *IS* curve?
  - c) Derive the equation of the *LM* curve and its slope.
  - d) What is the definition of the *LM* curve?
  - e) Derive the equilibrium levels of income and the interest rate.
  - f) What is the value of  $\alpha_G$  which corresponds to the simple Keynesian multiplier?

- g) By how much does an increase in government spending of  $\Delta G$  increase the level of income in the  $IS-LM$  model? (Suppose  $\Delta G=300$ )
  - h) By how much does an increase in government spending of  $\Delta G=300$  affect the equilibrium level of the interest rate?
  - i) Explain the difference between your answer in part f) and part g).
5. "In the early 1980s, U.S. fiscal policy was very expansionary; this helped to foster economic growth in the rest of the world." Comment on this statement, using the diagrams of the IS-LM-BP or the Mundell-Fleming models as much as possible.