Sample examination paper

FACULTY OF COMMERCE
AUTUMN SESSION EXAMINATION
ECO120 MACROECONOMICS

COORDINATOR : Dr. P. K. Basu

DAY & DATE: TIME: 13.50 – 17.00 hours
WRITING TIME: Three hours READING TIME: Ten minutes
MATERIALS SUPPLIED BY UNIVERSITY: General Purpose Answer Sheet
1 x 24 pg answer booklet
MATERIALS PERMITTED IN EXAMINATION: Battery/solar calculator (no
printer), 2B Pencil, eraser,
simple English dictionary.

NUMBER OF QUESTIONS:
Part A: 40; Part B: 2 out of 4;
Part C: 2 out of 4

INSTRUCTIONS TO CANDIDATES:
1. Enter your name and student number and sign in the space provided at the bottom
of this page.
2. This is a closed book examination; therefore no written material, reference books
or notes will be permitted into the examination room.
3. Write your answers in the answer booklets provided except for Part A which is to
be answered on the General Purpose Answer Sheet. Number each question
clearly.
   Part A (multiple choice): Answer all questions (40 marks)
   Part B (short answer ): Answer 2 only of the 4 questions (20 marks)
   Part C (essay questions): Answer 2 only of the 4 questions (40 marks)

INSTRUCTIONS TO INVIGILATORS:
The question paper and answer booklets must not be retained by the candidate.

| STUDENT NAME: ............................................ | STUDENT NO.: ..................... |
| STUDENT SIGNATURE: .......................................................... |
PART A
Multiple Choice Questions

(40 marks)

Answer all forty (40) questions.

1. Which of the following statements is true about a market economy?
   a) Market participants act as if guided by an ‘invisible hand’ to produce outcomes that maximise social welfare.
   b) Taxes help prices communicate costs and benefits to producers and consumers.
   c) With a large enough computer, central planners could guide production more efficiently than markets.
   d) The strength of a market system is that it tends to distribute resources evenly across consumers.

2. By definition, autonomous expenditure is not affected by changes in
   a) The price level
   b) Real GDP
   c) The interest rate
   d) The foreign exchange rate

3. If 1998 is the base year for the GDP deflator
   a) Nominal GDP is equal to real GDP in 1998
   b) Nominal GDP is greater than real GDP in 1998
   c) Nominal GDP is less than real GDP in 1998
   d) None of the above

4. If real GDP decreased from 1995 to 1996, then
   a) Only prices decreased from 1995 to 1996
   b) Output decreased from 1995 to 1996
   c) It cannot be determined whether output or prices or both decreased from 1995 to 1996
   d) Output and prices both must have decreased from 1995 to 1996

5. Macroeconomics is concerned with
   a) Only long-run trends in economic activity.
   b) Only short-run fluctuations in the business cycle.
   c) Both long-run trends and short-term fluctuations in economic activity.
   d) Only with changes in the overall price level.

6. Which of the following expressions represents disposable income?
a) Y – T  
b) C + S + T + IM  
c) C + I + G  
d) C + I + G + EX

7. If consumption is $25,000 when income is $21,000, and consumption increases to $25,900 when income increases to $22,000, the MPC is 
   a) 0.59  
   b) 0.84  
   c) 0.9  
   d) 1.11

8. Which of the following is held constant along an AE curve?
   a) Real GDP.  
   b) Consumption expenditure.  
   c) The price level.  
   d) All of the above.

9. In a two-sector economy, if the consumption function is C = 10 + 0.8 Y and planned investment is $15, the equilibrium expenditure is 
   a) $50  
   b) $150  
   c) $125  
   d) $175

10. Real GDP measures the 
    a) Value of total production in terms of current prices  
    b) Value of goods minus the current services minus prices  
    c) General upward drift in the final market output  
    d) Value of total production in constant prices

11. If disposable income equals zero, we know that:
    a) Savings will be positive.  
    b) Savings will be negative.  
    c) Savings will be zero.  
    d) None of the above.

12. When economists speak of the “demand for money”, which of the following questions are they asking?
    a) How much cash do you wish you could have?  
    b) How much income would you like to earn?  
    c) How much wealth would you like?  
    d) What proportion of your financial assets do you want to hold in noninterest bearing forms?
13. Which of the following is accurate?

a) When the price level decreases, the value of money decreases.
b) When the price level decreases, the value of money increases.
c) When the price level decreases, the value of money remains the same.
d) None of the above.

14. If the real interest rate is 5% and the nominal rate of interest is 7.5% the inflation rate must be

a) 10%
b) 24%
c) 2%
d) 2.5%

15. Investment is:

a) The purchase of shares and bonds.
b) The purchase of capital equipment and structures.
c) When we place our savings in the bank.
d) The purchase of goods and services.

16. As the economy nears full capacity, the short-run aggregate supply curve

a) Becomes flatter
b) Becomes steeper
c) Shifts to the right
d) Shifts to the left

17. If equilibrium real GDP is less than its long run level

a) There is a recessionary gap
b) The economy is not in short-run macroeconomic equilibrium
c) The economy is in a below full employment equilibrium
d) Both (a) and (c) are correct

18. The multiplier in an open economy is ------------------ than in a closed economy because, as income level increases, ------------------.

a) Greater, there is a wider market available
b) Smaller, some of the increase will be used to buy imports
c) Greater, exports become more attractive to foreigners
d) Smaller, consumers buy goods that had previously been sent abroad.

19. Which of the following occurs when the economy is in long run macroeconomic equilibrium

a) Actual real GDP = potential real GDP
b) Actual unemployment rate = natural unemployment rate
c) The labour market is in full employment equilibrium
d) All of the above

20. The way monetary policy is conducted in Australia is:

a) Changing government expenditure.
b) Changing the money supply, government purchases and taxation.
c) Varying the reserve ratio.
d) Open market operations to influence the cash rate.

21. If government spending exceeds tax collections,

a) There is a budget surplus.
b) There is a budget deficit.
c) Private savings is positive.
d) Public savings is positive.

22. An expansionary fiscal policy increases aggregate demand by:

a) Reducing the interest rate.
b) Increasing autonomous spending.
c) Lowering the demand for money.
d) Increasing the money supply.

23. Stagflation is the most difficult macroeconomic problem to address because

a) If the RBA expands the money supply, the inflation rate will fall, but so will output, which is already quite low
b) If the RBA reduces the money supply, the output will rise, but so will the inflation rate, which is already quite low
c) If the RBA expands the money supply, the inflation rate will rise even higher and output will fall even lower
d) If the RBA reduces the money supply, the inflation rate will fall, but so will output, which is already quite low

24. The investment demand curve plots the relationship between planned investment expenditure and

a) The nominal interest rate
b) The real interest rate
c) The price level
d) The real GDP

25. Frank has just finished school, but has not yet begun to look for a job. As a result,

a) The unemployment rate increases, and the labour-force participation rate decreases.
b) The unemployment rate increases, and the labour-force participation rate is unaffected.
c) The unemployment rate increases, and the labour-force participation rate increases.
d) The unemployment rate is unaffected, and the labour-force participation rate is unaffected.

26. Cyclical unemployment refers to:

a) That portion of the labour force consisting of individuals who qualify for employment but who are temporarily out of work.
b) That portion of the labour force consisting of individuals who are unemployed because of business cycle fluctuations.
c) That portion of the labour force consisting of individuals who would like to work but who lack skills and other attributes needed to obtain work.
d) The natural unemployment rate.

27. Structural unemployment is caused by:

a) ‘Friction’ in the labour force.
b) Cyclical changes in aggregate demand.
c) Technological innovation causing some skills to become outdated.
d) Seasonal changes in consumer expenditure.

28. The Phillips curve suggests that:

a) An increase in inflation temporarily increases unemployment.
b) A decrease in inflation temporarily increases unemployment.
c) Inflation and unemployment are unrelated in the short run.
d) None of the above.

29. A recession is a

a) Negative growth rate in real GDP that lasts one quarter
b) Negative growth rate in real GDP that lasts two weeks
c) Negative growth rate in real GDP that lasts two quarters
d) Negative growth rate in real GDP that lasts two months

30. When the economy is facing high inflation, the government should

a) Increase spending and taxation
b) Reduce spending and taxation
c) Increase spending and reduce taxation
d) Reduce spending and increase taxation

31. Profits earned in Australia by foreign-owned companies are included in its

a) Both GDP and GNP
b) Neither GDP nor GNP
c) GNP but not GDP
d) GDP but not GNP
32. The United States placed a limit on the amount of steel that can be imported into the United States. This is an example of

a) a tariff.
b) a quota.
c) an export subsidy.
d) dumping.

33. As real GDP increases

a) Exports increase, but imports decrease
b) Imports increase, but exports decrease
c) Imports increase, but exports are independent of real GDP
d) Exports increase, but imports are independent of real GDP

34. A nation with a capital account surplus must be :

a) A net debtor nation.
b) A net creditor nation.
c) A gross creditor nation.
d) None of the above.

35. If private sector investment exceeds private savings :

a) The private sector has a surplus to lend to other sectors.
b) The current account must be in deficit.
c) The private sector has a deficit which must be financed by borrowing from other sectors.
d) The government sector balance must also be negative.

36. More Japanese companies start to invest in Australia. This will lead to :

a) A decrease in the demand for dollars and an increase in the demand for yen
b) An increase in the supply of dollars and a decrease in the demand for yen.
c) An increase in the demand for dollars and an increase in the supply of yen
d) An increase in the demand for dollars and a decrease in the supply of yen.

37. The purchasing power parity theory states that

a) Exchange rates will adjust so that the same quantity of internationally traded goods can be bought in all countries with a given amount of one currency.
b) Interest rates will adjust so that the inflation rate is equalised in all countries so as to maintain the relative value of real incomes.
c) The exchange rate between currency A and B and between B and C and between C and A will be such that all three rates are consistent.
d) The exchange rate between any two currencies at any one time will be the same in all foreign exchange dealing centres in any part of the world.
38. According to the theory of comparative advantage, specialisation will benefit all trading partners,

a) Even those that may be absolutely less efficient producers.
b) Except those that may be absolutely less efficient producers.
c) Except those that may be relatively more efficient producers.
d) Except those that may be relatively less efficient producers.

39. If the Australian dollar depreciates in the foreign exchange market:

a) Foreigners find Australian goods more expensive.
b) Foreigners find Australian goods less expensive.
c) The dollar buys more in the foreign goods market.
d) Imported goods cost Australians less.

40. A reasonable measure of the standard of living in a country is:

a) Real GDP per person.
b) Real GDP
c) Nominal GDP per person
d) The growth rate of nominal GDP per person.
PART B

(20 marks – 10 marks each)

Answer two (2) only of the four (4) questions

Please draw diagrams when applicable

QUESTION: B.1 (1 x 10 = 10 marks)

1. State whether the following statements are true or false. State reasons clearly. No marks will be given for an unsubstantiated claim.
   i) Net exports are equal to: GDP – (C + I + G).
   ii) The marginal propensity to save (MPS) is the change in consumption divided by the change in disposable income.
   iii) Changes in government expenditure (G) and/or exports can result in increase in GDP through multiplier effect.
   iv) The unemployment rate is defined as the number of unemployed divided by total population.
   v) The marginal propensity to consume (MPC) is equal to one minus marginal propensity to save (MPS).
   vi) A recessionary gap is the amount by which the aggregate expenditure exceeds the full employment level of GDP.
   vii) Aggregate expenditure in a closed economy is equal to (C+I+G).
   viii) The aggregate demand curve shows the relationship between real GDP and price level.
   ix) GDP excludes second-hand goods.
   x) Multiplier tells us that an increase in investment by $ 100 million will give rise to a smaller than $ 100 million increase in GDP.

QUESTION: B.2 (6 + 4 = 10 marks)

Briefly explain the concept of consumption function. Explain how changes in net wealth and the price level alter the consumption function.

QUESTION: B.3 (2.5 x 4 = 10 marks)

The reserve ratio for the banks is 25%. ABC Bank has $ 20,000 in deposits and $12,000 in liquid assets (cash). Assume all other commercial banks are loaned up.

a) What is the value of ABC Bank’s excess liquidity?
b) What is the value of the additional loans that can be made by the commercial banking system?
c) What is the money multiplier?
d) By how much will total deposits expand if this bank lends all its excess reserves and there is no leakage from the banking system?
What adverse internal effects may follow from
a) a depreciation of the exchange rate and
b) an appreciation of the exchange rate?
PART C

(40 marks – 20 marks each)

Answer two (2) only of the four (4) questions

Please draw diagrams when applicable

QUESTION: C.1  
(15 + 5 = 20 marks)

a) Use the aggregate demand–aggregate supply model to compare the causes and policy implications of (i) demand-pull and (ii) cost-push inflation in both the short run and the long run.

b) In what way does the presence of cost-push inflation make demand-management policy ineffective?

QUESTION: C.2  
(10 + 10 = 20 marks)

a) Define the crowding-out effect.

b) Is the crowding-out effect likely to be larger during recession or when the economy is near full employment?

c) Use the aggregate demand–aggregate supply model to substantiate your answer?

QUESTION: C.3  
(5 + 10 + 5 = 20 marks)

a) Define unemployment.

b) Outline the causes of frictional, Structural and cyclical unemployment.

c) What are the main policies for dealing with each type of unemployment?

QUESTION: C.4  
(10 + 10 = 20 marks)

a) What is the relationship between savings and investment? Explain whether Australia is a high or a low saver economy.

b) When a country is considered as a ‘debtor’ or a ‘creditor’ country? Is Australia a net debtor or a creditor country to the rest of the world? Explain.
Answers to MCQs – Autumn 2002

1. a
2. b
3. a
4. c
5. c
6. a
7. c
8. c
9. c
10. d
11. b
12. d
13. b
14. d
15. b
16. b
17. d
18. b
19. d
20. d
21. b
22. b
23. d
24. b
25. d
26. b
27. c
28. b
29. c
30. d
31. d
32. b
33. c
34. a
35. c
36. c
37. a
38. a
39. b
40. a