ECO 209Y MACROECONOMIC THEORY AND POLICY

Term Test #1								
	LA	ST NAME						
FIRST NAME								
STUDENT NUMBER								
Indicate your section of the course:								
	Tue	esday, 10-12 – L0101		Tuesday, 2-4 – L0201				
	□ Wednesday, 2-4 – L0301 □ Thursday, 2-4 – L0							
INSTRUCTIONS:								
	 The total time for this test is 1 hour and 45 minutes. Aids allowed: a <u>simple</u>, non-programmable calculator. Use <u>pen</u> instead of <u>pencil</u>. 							
		DO NOT WRITE IN THI	S SP/	ACE				
Part I		/30	P	art III	1	/10		
Part II		/20			2	/10		
					3	/10		

TOTAL	/80
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PART I (30 marks)

Instructions:

- Enter your answer to each question in the table below.
- Each correct answer is worth 3 marks. *Note that a deduction of 0.5 mark will be made for each incorrect answer.* Table cells left blank will receive a zero mark (i.e., no deduction).
- Do NOT guess your answers!

1	2	3	4	5	6	7	8	9	10
Co	orrect:		Inco	orrect:		E	Blank:		

- 1. If investment exceeds private saving by \$22 billion and government spending exceeds tax revenues by \$34 billion, then
 - A) the trade deficit is \$56 billion.
 - **B**) the trade surplus is \$56 billion.
 - **C)** the trade deficit is \$12 billion.
 - **D)** the trade surplus is \$12 billion.
 - E) we cannot say anything about the international trade balance.
- 2. Suppose exports receipts are 115, imports payments are 110, income from assets receipts are 20, income from assets payments are 30, and net gifts and grants are nil. Which of the following is true?
 - A) There is a Current Account surplus and GDP is greater than GNP.
 - B) There is a Current Account surplus and GDP is less than GNP.
 - **C)** There is a Current Account deficit and GDP is greater than GNP.
 - D) There is a Current Account deficit and GDP is less than GNP.
 - E) The Current Account is balanced and GDP is greater than GNP.
- **3.** Consider a hypothetical closed economy with a tax rate (*t*) equal to 0.25 and an aggregate expenditure multiplier (α_{AE}) equal to 2.5. If the tax rate is reduced to 0.15, the aggregate expenditure multiplier would now be equal to
 - **A)** 2.175.
 - **B**) 3.175.
 - **C)** 5.125.
 - **D**) 3.125.
 - **E)** 4.125.

Use this space for rough work.

The information in the following table describes a hypothetical economy, where prices are expressed in dollars and quantities in units. Use this data to answer questions 4 and 5 below.

	2	013	2014		
	Price	Quantity	Price	Quantity	
Good A	4	50	5	40	
Good B	9	40	9	50	
Good C	9	10	10	8	

- **4.** Using the chain method, real GDP ______ by approximately ______ percent in 2014.
 - A) increased; 2.4.
 - B) increased; 3.8.
 - **C)** increased; 3.1.
 - **D)** decreased; 2.2.
 - E) decreased; 3.9.
- 5. Taking 2013 as the base period, according to the GDP deflator the annual rate of inflation was approximately ______ percent in 2014.
 - **A)** -7.1.
 - **B)** 6.5.
 - **C)** -5.9.
 - **D)** 7.5.
 - **E)** 7.0.
- **6.** Suppose that the value of Canada's aggregate expenditure multiplier is 3 (i.e., $\alpha_{AE} = 3$). The Canadian government buys a house in Mexico City for its ambassador to Mexico at a cost of \$2,000,000. Which of the following best describes the likely outcome of this transaction on the Canadian economy?
 - A) Investment increases by \$2,000,000 and GDP rises by \$6,000,000.
 - **B)** Government spending increases by \$2,000,000 and GDP rises by \$6,000,000.
 - **C)** Government spending increases by \$2,000,000 but GDP does not change.
 - D) Investment increases by \$2,000,000 but GDP does not change.
 - **E)** Government spending and investment increase each by \$2,000,000 and GDP rises by \$12,000,000.

Use this space for rough work.

- **7.** Consider a closed economy with a fixed price-level and a balanced government budget at the initial equilibrium. A drop in government purchases will cause
 - A) business inventories to rise and a government budget surplus, but no change in consumption.
 - **B)** both consumption and business inventories to fall, but no change in the government budget balance.
 - C) both consumption and business inventories to fall, and a government budget surplus.
 - **D)** a government budget surplus but no change in either consumption or business inventories.
 - E) consumption to fall, business inventories to rise, and a government budget surplus.
- **8.** Data recently released by Statistic Canada indicates that the unemployment rate edged up from 7.0 percent to 7.1 percent in September (*The Globe and Mail*, 09 Oct 2015). Which of the following explains this outcome?
 - A) Employment fell while the labour force remained basically unchanged.
 - B) Employment expanded but the labour force grew much faster.
 - C) Both employment and the labour force contracted.
 - D) Employment remained basically unchanged while the labour force expanded.
 - E) While full-time jobs increased, part-time jobs decreased at a greater pace.
- **9.** The incoming Liberal government is proposing an increase in infrastructure spending. Which of the following might best describe the likely outcome of such policy?
 - A) Both current income and government deficit will rise but potential income will remain unchanged.
 - **B)** Both current income and potential income will rise but government deficit will remain unchanged.
 - **C)** Current income will rise but both potential income and government deficit will remain unchanged.
 - D) Current income, potential income, and government deficit will all rise.
 - E) Both current income and government deficit will rise but potential income will fall.
- **10.** Which of the following would cause the IS curve to shift outwards?
 - A) A decrease in autonomous imports.
 - **B)** A decrease in autonomous investment.
 - C) A decrease in the rate of interest.
 - D) An increase in autonomous private savings.
 - **E)** Both C) and D) are correct.

Use this space for rough work.

PART II (20 marks)

Consider the following economy:

C = 100 + 0.9 YD I = 400 - 20i G = 300 TR = 200 TA = 0.2 Y NX = 100 - 0.12 Y $Y_{fe} = 2500$

a) What is the equation for the AE curve in this economy? Show <u>all</u> your work. (2 marks)

b) If *i* = 6, what is the level of equilibrium income (Y*) in this economy? **(2 marks)** Show <u>all</u> *your work.*

c) What is the value of the marginal propensity to consume out of income (MPC_Y) ? What is the value of the marginal propensity to import (*m*)? What is the value of the marginal propensity to spend (*z*)? What is the size of the aggregate expenditure multiplier (α_{AE})? (4 marks) Show <u>all</u> your work.

d) What is the level of private saving (*S*) when the economy is in equilibrium? (2 marks) What is the level of national saving (*NS*) when the economy is in equilibrium? (2 marks) Show <u>all</u> your work.

e) If the government decides to implement expansionary fiscal policy to move the economy to full employment (Y_{fe}), by how much should it increase its purchases of goods and services (G)? (2 marks) What will be the size of the government budget surplus (BS) now? (2 marks) Show <u>all</u> your work.

f) Go back to the equilibrium of part b) above. If the government decides to achieve full employment (Y_{fe}) by changing the rate of interest (*i*), at what level should it set the rate of interest? (2 marks) What will be the size of the government budget surplus (*BS*) now? (2 marks) Show <u>all</u> your work.

PART III (30 marks)

Instructions: Answer the following three questions in the space provided. You may continue your answers on pages 11-12 if additional space is required (**but clearly indicate that your answer continues on page 11 or 12**). Each question is worth 10 marks.

1. Critically comment on the following statement: "When the economy is booming, government expenditure must be cut in order to reduce demand and inflationary pressure. When the economy is tanking, government expenditure must also be cut in order to reduce the government deficit and restore the confidence of the private sector."

2. Critically comment on the following statement: *"In a closed economy, national saving is equal to actual investment. Therefore, the government should implement policies that encourage greater saving to help the economy get out of a recession."* (Show your answer with the help of a diagram and <u>explain</u> the economics.)

3. Critically comment on the following statement: *"If the government increases income taxes on the rich while reducing (by the same amount) income taxes on the middle class, both equilibrium income and the government budget deficit will remain unchanged."* (Show your answer with the help of a diagram and <u>explain</u> the economics.)

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