

EC10007

The University of Bath

DEPARTMENT OF ECONOMICS AND INTERNATIONAL DEVELOPMENT

Year 1 : Semester II : EC10007

INTRODUCTORY MACROECONOMICS

Tuesday, 29 May 2007. 0930 - 1130

A University calculator is required for this examination

ANSWER QUESTION 1 IN SECTION A

AND

ANY TWO QUESTIONS FROM SECTION B

Section A: 25% Section B: 75%

All questions in Section B carry equal marks

**CANDIDATES MUST NOT TURN OVER THE PAGE AND READ THE
EXAMINATION PAPER UNTIL THE CHIEF INVIGILATOR
GIVES PERMISSION TO DO SO**

Please fill in your name and sign in the section on the right of your
answer book/cover, peel away adhesive strip and seal.

Take care to enter the correct candidate number as
detailed on your desk label.

EC10007: INTRODUCTORY MACROECONOMICS

Answer Question 1 in Section A and any TWO questions from Section B.

SECTION A

1. Answer any TEN questions. Each of these account for two and a half marks. The question counts for 25% of the overall marks. As a guide you should spend an average of three minutes on each of these and no longer than 30 minutes on Section A overall.

- (a) Relating to investment, what is the accelerator?
- (b) Draw the circular flow of income for a world with two economies. That is you should draw two circular flows with the linkages between them.
- (c) Write the national income identity for (i) a closed and (ii) an open economy.
- (d) In the following closed economy model:

$$\begin{aligned} Y &= C + I + G \\ C &= 100 + 0.7YD \\ YD &= 0.4Y \end{aligned}$$

Where YD is real disposable income and the other variables have their standard interpretation, GDP is 4000. What is the average propensity to consume out of disposable income? What is the marginal propensity to consume?

- (e) What are (i) the menu costs and (ii) the shoe leather costs of inflation?
- (f) What is the rational expectations theory of inflation?
- (g) BRIEFLY describe the quantity theory of money.
- (h) What is the monetary policy committee of the Bank of England and what does it do?
- (i) How can real GDP increase by 2% and nominal GDP increase by 2%?
- (j) In the following closed economy model, derive the multiplier:

$$\begin{aligned} Y &= C + I + G \\ C &= 100 + 0.7YD \\ YD &= 0.4Y \end{aligned}$$

Where YD is real disposable income and the other variables have their standard interpretation.

- (k) What is demand deficient (sometimes called cyclical) unemployment?
- (l) In the following equation
- $$\ln(M_t) = 100.0 + 0.4\ln(Y_t) - 0.5\ln(P_t) + 0.5\ln(M_{t-1})$$
- where M = imports, Y = GDP, P a measure of the relative price of imports
- what impact does a 5% increase in GDP have on imports in (i) the short-run and (ii) the long-run?
- (m) What is the purchasing power parity theory of exchange rate determination?
- (n) Give three types of motive for holding money.
- (o) What role has it been suggested that sunspots play in impacting on economic cycles?
- (p) What is the Konratief Cycle?

SECTION B

Answer any TWO questions

In the case of multipart questions the proportion of marks relating to each part is indicated in brackets. Students should allocate their time accordingly.

2. (i) Compare the Keynesian consumption function with Friedman's permanent income model of consumption. In both cases what is the impact of an increase in disposable income on consumption?
(60%)
- (ii) What factors determine investment? What is the impact of an increase in interest rates on investment?
(40%)
3. (i) Using IS and LM curves analyse the impact of (a) a cut in government spending and (b) a cut in taxation on the economy.
(50%)
- (ii) Using aggregate supply and demand analysis, analyse the impact of (a) a cut in government spending and (b) a cut in taxation on the economy.
(50%)

In both cases your answers should contain some discussion on the theoretical basis for the two approaches, i.e. how the two sets of curves are derived.

4. What determines the NAIRU? Included in this should be an analysis of the role of the expectations augmented Phillips curve.
5. Discuss the process of building a macroeconomic model. What are macroeconomic models used for and what is the role of 'con' or 'residual' adjustment in macroeconomic modeling? Why do forecasts from one macroeconomic model differ from another?
6. Answer EITHER:
- (i) Compare the UK bankruptcy system with at least one other. Which do you feel is 'better'?

OR

- (ii) What determines the effectiveness of development aid in stimulating economic growth in developing countries? How effective has it been in the past? How can its effectiveness be increased in the future?