

University of Calgary
Department of Economics
Economics 203 (07)
Midterm 2 Exam

Version 2

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MARKS: 50

INSTRUCTIONS:

Answer all 50 questions. Choose the best answer and mark your choice with a pencil on the Scantron sheet provided.

A calculator (programmable or non-programmable) will be allowed during the writing of this examination.

MULTIPLE CHOICE:

1. The aggregate demand curve:

- ☒ A) shows the amount of real output which will be purchased at each possible price level.
☐ B) is upsloping because a higher price level is necessary to make production profitable as production costs rise.
☐ C) is downsloping because production costs decline as real output increases.
☒ D) shows the amount of expenditures required to induce the production of each possible level of real output. *very b/m*

2. The foreign trade effect suggests that a decrease in the Canadian price level relative to other countries will:

- ☒ A) increase Canadian exports and decrease Canadian imports.
☐ B) decrease Canadian exports and increase Canadian imports.
☐ C) shift the aggregate demand curve leftward.
☐ D) shift the aggregate supply curve leftward.

3. All else equal, an increase in imports will shift the aggregate expenditures curve:

- ☒ A) downward and the aggregate demand curve leftward.
☐ B) downward and the aggregate demand curve rightward.
☐ C) upward and the aggregate demand curve leftward.
☐ D) upward and the aggregate demand curve rightward.

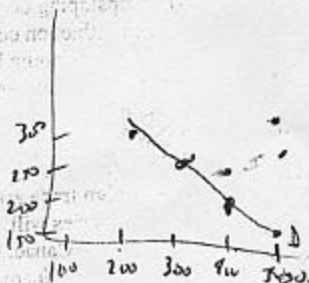
4. Other things equal, a decrease in the price level will:
- A) cause a movement up a short-run aggregate supply curve.
 - B) cause a movement down an aggregate supply curve.
 - C) shift the aggregate demand curve to the left.
 - D) shift the aggregate supply curve to the left.
5. The short run aggregate supply curve:
- A) is explained by the interest rate, wealth, and foreign purchases effects.
 - B) contains a vertical range where real output is variable and the price level is constant.
 - C) is downsloping because real purchasing power increases as the price level falls.
 - D) shows the various amounts of real output which businesses will produce at each price level.
6. Other things equal, an improvement in productivity will:
- A) increase the price level.
 - B) shift the aggregate supply curve to the right.
 - C) shift the aggregate supply curve to the left.
 - D) shift the aggregate demand curve to the left.



Use the following to answer questions 7-8:

The following aggregate demand and supply schedules are for a hypothetical economy:

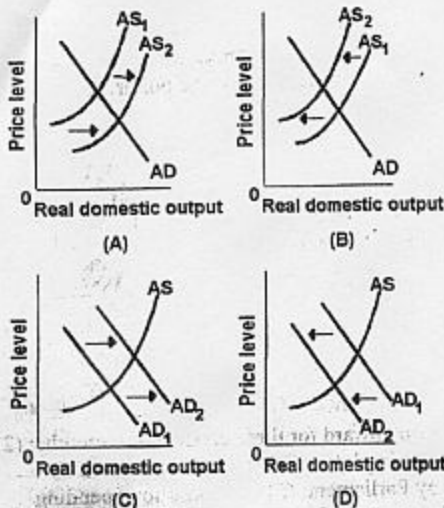
Amount of real output demanded	Price level (index value)	Amount of real output supplied
\$200	300	\$500
300	250	500
400	200	400
500	150	300
500	150	200



7. Refer to the above data. The vertical range of the aggregate supply curve is associated with price levels:
- A) 150 and 300.
 - B) 250 and 300.
 - C) 200 and 250.
 - D) 150 and 200.
8. Refer to the above data. The equilibrium price level will be:
- A) 200.
 - B) 150.
 - C) 300.
 - D) 250.

9. Real output rises and the price level falls, this would likely be due to a:
- A) rightward shift of the aggregate demand curve.
 B) leftward shift of the aggregate demand curve.
 C) leftward shift of the aggregate demand curve.
 D) rightward shift of the aggregate supply curve.

Use the following to answer question 10:



10. Which of the above diagrams best portrays the effects of declines in the incomes of other major nations with whom we trade?

A) A B) B C) C D) D

11. Fiscal policy is carried out primarily by:

A) the federal government.
 B) local governments alone.
 C) provincial and local governments working together.
 D) provincial governments alone.

12. Countercyclical discretionary fiscal policy calls for:

A) deficits during recessions and surpluses during periods of demand-pull inflation.
 B) deficits during both recessions and periods of demand-pull inflation.
 C) surpluses during recessions and deficits during periods of demand-pull inflation.
 D) surpluses during both recessions and periods of demand-pull inflation.

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13. Fiscal policy refers to the: *Govt spending & taxes*
- (A) manipulation of government spending and taxes to stabilize domestic output, employment, and the price level.
 (B) fact that equal increases in government spending and taxation will be contractionary.
 (C) altering of the interest rate to change aggregate demand.
 (D) manipulation of government spending and taxes to achieve greater equality in the distribution of income.
14. An appropriate fiscal policy for severe demand-pull inflation is:
- (A) an increase in government spending.
 (B) a reduction in interest rates.
 (C) a tax rate increase.
 (D) depreciation of the dollar.
15. An expansionary fiscal policy is shown as a:
- (A) leftward shift in the economy's aggregate demand curve.
 (B) movement along an existing aggregate demand curve.
 (C) leftward shift in the economy's aggregate supply curve.
 (D) rightward shift in the economy's aggregate demand curve.

Use the following to answer questions 16-17:

1) The composite index of leading indicators turns downward for three consecutive months; (2) Economists reach agreement that the economy is moving into a recession; (3) A tax cut is proposed in Parliament; (4) The tax cut is passed by Parliament; (5) Consumption spending begins to rise, aggregate demand increases, and the economy begins to recover.

16. Refer to the above information. The recognition lag of fiscal policy is reflected in events:
- (A) 4 and 5. (B) 3 and 4. (C) 1 and 2. (D) 2 and 3.

17. Refer to the above information. The administrative lag of fiscal policy is reflected in events:
- (A) 4 and 5. (B) 1 and 2. (C) 3 and 4. (D) 2 and 3.

Fiscal

Monetary

Boon Contraction
↑ T ↓ G

Expanding recession
BT AD

Expans	MS ↑ AD ↑	Inflation / Growth
Buy	Interest ↓	MS ↓ AD ↓
		Interest ↑

18. The "crowding-out effect" suggests that:

- A) consumer and investment spending always vary inversely.
 B) tax increases are paid primarily out of saving and therefore are not an effective fiscal device.
 C) it is very difficult to have excessive aggregate spending in our economy.
 D) increases in government spending financed through borrowing will increase the interest rate and thereby reduce investment.

Use the following to answer question 19:

The following budget information is for a hypothetical economy. All data are in billions of dollars.

	Government spending	Tax revenues	GDP
Year 1	\$450	\$425	\$2000
Year 2	500	450	3000
Year 3	600	500	4000
Year 4	640	620	5000
Year 5	680	580	4800

19. Refer to the above data. The budget deficit in year 3 is:

- A) \$3050 billion. B) \$175 billion. C) \$295 billion. D) \$100 billion.

20. Between 1980 and 1997 the federal debt:

- A) increased on a per capita basis.
 B) increased as a percentage of the GDP.
 C) increased absolutely.
 D) did all of the above.

21. Other things equal, the stock of capital inherited by future generations is likely to be smaller when government spending:

- A) increases during a period of recession, rather than prosperity.
 B) is financed by borrowing.
 C) is financed by taxation.
 D) is primarily for capital-type goods.

22. Money functions as:

- A) a unit of account.
 B) a medium of exchange.
 C) a store of value.
 D) all of the above.

$$I = (G + T_{pp} + TR)$$

$$4500 = (600 + 500 + TR)$$

23. What function is money serving when you buy a ticket to a movie?
 A) a unit of account
 B) a transaction demand
 C) a medium of exchange
 D) a store of value
24. In Canada the money supply ($M1$) is comprised of:
 A) paper currency, coin, gold certificates, and time deposits.
 B) coins, paper currency, demand deposits, and credit balances with brokers.
 C) currency, notice deposits, and bonds.
 D) coins, paper currency, and demand deposits.
25. Fiat money is:
 A) comprised only of demand deposits.
 B) money that can be redeemed for an intrinsically valuable commodity such as gold.
 C) money because the government asserts that it is.
 D) money that is "resting" in a chartered bank vault.
26. Suppose the ABC bank has excess reserves of \$4,000 and outstanding demand deposits of \$80,000. If the desired reserve ratio is 25 percent, what is the size of the bank's actual reserves?
 A) \$24,000 B) \$16,000 C) \$20,000 D) \$84,000
27. If you deposit a \$50 bill in a chartered bank that has a 10 percent desired reserve ratio, the bank will:
 A) have \$50 of additional excess reserves.
 B) be capable of lending an additional \$50.
 C) be capable of lending an additional \$500.
 D) have \$50 of desired reserves.
 E) have \$45 of additional excess reserves.
28. If the desired reserve ratio is 15 percent and chartered bankers decide to hold additional excess reserves equal to 5 percent of any newly acquired demand deposits, then the relevant money multiplier for the banking system will be:
 A) $3 \frac{1}{2}$ B) $6 \frac{2}{3}$ C) 4 D) 10 E) 8
29. If the desired reserve ratio falls:
 A) banks would be prompted to reduce their lending.
 B) the actual reserves of banks would increase.
 C) the size of the money multiplier would increase.
 D) none of the above would occur.

30. Which of the following is *not* a tool of monetary policy?

- ☐ A) changes in the bank rate
☐ B) open-market operations
☒ C) switching government deposits into and out of the chartered banks
☐ D) changes in tax rates

31. In the Canadian economy, the money supply is controlled by

- ☐ A) the Governor in Council (the Cabinet).
☐ B) Parliament.
☐ C) the Department of Finance.
☐ D) the House of Commons Committee on Finance.
☒ E) the Bank of Canada.

32. Which of the following statements best describes the Bank of Canada? It is:

- ☒ A) a publicly owned and publicly controlled central bank, whose basic goal is to control the money supply and interest rates in promoting the general economic welfare.
☐ B) a publicly owned and publicly controlled central bank, whose basic goal is to provide income for the Government of Canada.
☐ C) a privately owned and privately controlled central bank, whose basic goal is to provide an ample and orderly market for Government of Canada securities.
☐ D) a privately owned and publicly controlled central bank, whose basic goal is to earn profits for its owners.
☐ E) a privately owned and publicly controlled central bank, whose basic function is to minimize the risks in chartered banking in order to make it a reasonably profitable industry.

33. "Open-market operations" refers to:

- ☐ A) central bank lending to chartered banks.
☐ B) the specifying of margin requirements on stock purchases.
☒ C) the purchase or sale of government securities by the Bank of Canada.
☐ D) purchases of stocks in the Toronto Stock Exchange.

34. If the Bank of Canada buys government securities from chartered banks and the public:

- ☒ A) the money supply will contract.
☐ B) it will be easier to obtain loans at chartered banks.
☐ C) chartered bank reserves will be unaffected.
☐ D) chartered bank reserves will decline.

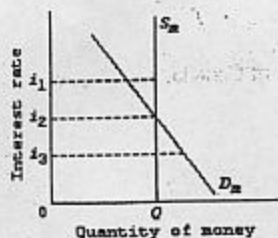
35. The bank rate is the rate of interest at which:
- A) chartered banks lend to large corporations.
 - B) the Bank of Canada lends to chartered banks.
 - C) financial institutions lend to some builders.
 - D) the Bank of Canada lends to large corporations.

36. The asset demand for money is most closely related to money functioning as a:
- A) store of value.
 - B) unit of account.
 - C) measure of value.
 - D) medium of exchange.

37. If the money GDP is \$600 billion and, on the average, each dollar is spent three times per year, then the amount of money demanded for transactions purposes:
- A) cannot be determined from the information given.
 - B) will be \$1800 billion.
 - C) will be \$600 billion.
 - D) will be \$200 billion.
- $3 = \frac{600}{x}$

38. In which of the following instances can we be certain that the quantity of money demanded by the public will decrease?
- A) nominal GDP increases and the interest rate increases
 - B) nominal GDP decreases and the interest rate decreases
 - C) nominal GDP decreases and the interest rate increases.
 - D) nominal GDP increases and the interest rate decreases

Use the following to answer question 39:



39. Refer to the above money market diagram. The equilibrium interest rate is:
- A) i_1 .
 - B) i_2 .
 - C) i_3 .
 - D) not determinable without further information.

40. Which of the following statements is *correct*?

- ☒ A) Interest rates and bond prices vary directly.
☐ B) Interest rates and bond prices are unrelated.
☐ C) Interest rates and bond prices vary directly during inflations and inversely during recessions.
☒ D) Interest rates and bond prices vary inversely.

41. Which of the following best describes the cause-effect chain of a contractionary monetary policy?

- ☐ A) An increase in the money supply will raise the interest rate, decrease investment spending, and decrease GDP.
☒ B) An increase in the money supply will lower the interest rate, decrease investment spending, and increase GDP.
☐ C) A decrease in the money supply will raise the interest rate, decrease investment spending, and decrease GDP.
☒ D) A decrease in the money supply will lower the interest rate, increase investment spending, and increase GDP.

42. Inflationary pressure is a growing problem for the economy. Therefore, the Federal Reserve decides to pursue a policy to reduce the inflationary pressure. Which set of policy changes by the Fed would reinforce each other to achieve that objective?

- ☒ A) buying government securities and lowering the discount rate
☒ B) selling government securities and lowering the discount rate
☐ C) buying government securities and lowering the reserve ratio
☐ D) selling government securities and raising the discount rate

43. In terms of the aggregate demand and aggregate supply model, an expansionary monetary policy is designed to shift the:

- ☒ A) aggregate demand curve leftward.
☒ B) aggregate demand curve rightward.
☐ C) aggregate supply curve leftward.
☐ D) aggregate supply curve rightward.

44. Federal government debt in Canada is now roughly

- a. \$5.5 billion
 b. \$55 billion
 c. \$550 billion
 d. \$5.5 trillion

45. Which of the following Canadian provinces is generally considered a 'have' province in terms of per capita market income levels?

- a. Alberta
 b. Newfoundland
 c. Quebec
 d. Saskatchewan

46. Federal government fiscal policies have redistributed large amounts of money across regions in the last 40 years. In per capita terms, the primary recipient has been the province of _____ while the primary contributor has been the province of _____.

- a. Prince Edward Island, Alberta
 b. Prince Edward Island, Ontario
 c. Quebec, Alberta
 d. Quebec, Ontario

47. Fiscal policy has an advantage over monetary policy with respect to

- a. recognition lag
 b. decision (administrative) lag
 c. impact (operational) lag
 d. reversibility

48. If the interest rate is 4%, the present value of a perpetuity that pays \$400 annually is

- a. \$16
 b. \$385
 c. \$416
 d. \$10,000

49. If the present value of a bond that will pay \$1,000 in 2 years is \$940, the interest rate must be

- a. 1.03%
 b. 1.06%
 c. 3.14%
 d. 6.38%

50. Suppose a project involves an outlay of \$135,000 in the initial year of operations. In each of the three following years, revenues are \$95,000 and expenses are \$40,000. If the interest rate is 8%, the net present value of this project is

- a. \$6,740
 b. \$18,080
 c. \$30,000
 d. \$141,740
