***Name:*** ______________________

***Student Number:*** ____________

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question paper

# QUEEN'S UNIVERSITY AT KINGSTON

## *FACULTY OF ARTS AND SCIENCE*

### *Department of Economics*

ECONOMICS 110

Final Examination

**April 20, 2007**

**Instructors:** Ian Cromb (Econ 110A) Lorne Carmichael (Econ 110B)

**Time Limit:** 3 Hours

**Permitted Calculators:** Stickers: Blue and Gold Pre-Approved: Casio 991.

**Instructions:**

Mark your selections on the multiple choice answer card in PENCIL. If you make changes, be sure to erase completely. Please record your ***name***, ***student number***, ***course and section,*** and the ***number you see on the top left hand corner of this page*** on the multiple choice answer card.

***Part A*** consists of multiple-choice questions surveying the course material.

***Parts B-F*** each have a series of questions related to a particular problem. Try to do these questions in order since some of the answers depend on the answers to previous questions in the series.

**Marking Scheme:**

| | | |
|---|---|---|
| ***Part A*** | [40 marks] | FORTY multiple-choice questions - 1 mark each |
| ***Parts B-F*** | [40 marks] | FORTY multiple-choice questions in 5 series - 1 mark each |

**Note:**

Proctors are unable to respond to queries about the interpretation of exam questions. Do your best to answer exam questions as written.

***Part A*** [40 marks]

This section consists of 40 questions that survey the course material.

Each question is worth 1 mark.

1. A homeowner decides to buy three large dogs that sleep outdoors and howl at the moon. An externality associated with this decision is
   A. the increased work for the homeowner in yard cleanup.
   B. the cost of purchasing the dogs.
   C. the neighbours' lost sleep.
   D. the homeowner's lost sleep.
   E. the veterinary costs of keeping the dogs.

2. Competitive markets are unlikely to produce an efficient amount of a public good because
   A. there is no way to prevent a person not willing to pay for the good from receiving benefits from the good.
   B. of the cost of the public good.
   C. social benefits exceed social costs.
   D. of the existence of moral hazard.
   E. of the existence of adverse selection.

3. An income tax is progressive if, as income increases,
   A. its average tax rate is increasing.
   B. its marginal tax rate is falling.
   C. its average tax rate is falling, but total taxes are increasing.
   D. its average tax rate and marginal tax rate are constant while income is increasing.
   E. average tax rate is falling, but the marginal tax rate is increasing.

4. The concept of horizontal equity requires that
   A. households of the same size should share the same tax burden.
   B. individuals in the same age group should share the same tax burden.
   C. households with identical abilities to pay should bear the same tax burden.
   D. there is equity between different income classes.
   E. all should pay the same percentage of income as tax.

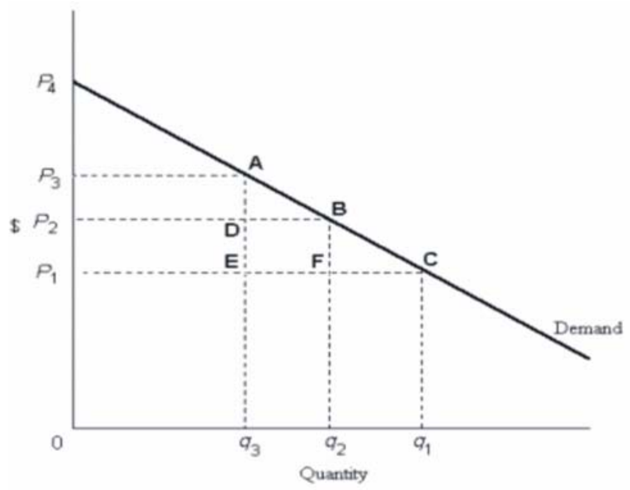



**Figure 5**

5. Refer to Figure 5. If a tax raises the price from $P_1$ to $P_2$, the excess burden is the area
   A. $P_3$A$P_4$.
   B. $P_2$B$P_3$.
   C. $P_1$CB$P_2$.
   D. BFC.
   E. $P_1$FB$P_2$.

6. If nominal national income increased 20 percent over a certain period of time while real national income increased by 10 percent then
   A. everybody in the economy became worse off.
   B. inflation has decreased during this time period.
   C. the labour force increased by 10 percent.
   D. the price level has declined by about 10 percent.
   E. the price level has increased by approximately 10 percent.

7. If 5 French francs can be exchanged for one Canadian dollar, the dollar price of a franc is
   A. \$5.00. B. \$2.00. C. \$1.00. D. \$0.50. E. \$0.20.

8. As the banking industry becomes more and more automated, tellers find themselves with unneeded skills at the same time that computer programmers and telephone banking specialists are in high demand. Such unemployed tellers would be classified as
   A. cyclically unemployed.
   B. frictionally unemployed.
   C. naturally unemployed.
   D. structurally unemployed.
   E. underemployed.

9. Consumption expenditures include which of the following purchases by households?
   A. legal services
   B. residential housing
   C. a Government of Canada Treasury bill
   D. tractors for use on a family farm
   E. the purchase of company stock

10. Which of the following is included in the current calculations of GDP?
    A. the purchase of a second hand automobile.
    B. pizza purchased by college students for dinner.
    C. volunteer work undertaken by Mary Smith.
    D. the purchase of a 1939 painting.
    E. welfare payments.

11. The term "investment" in macroeconomics means
    A. the total amount of capital goods in the country.
    B. the production of goods for immediate consumption.
    C. the same thing as profits.
    D. the production of goods not for immediate consumption use.
    E. money invested in financial capital markets.

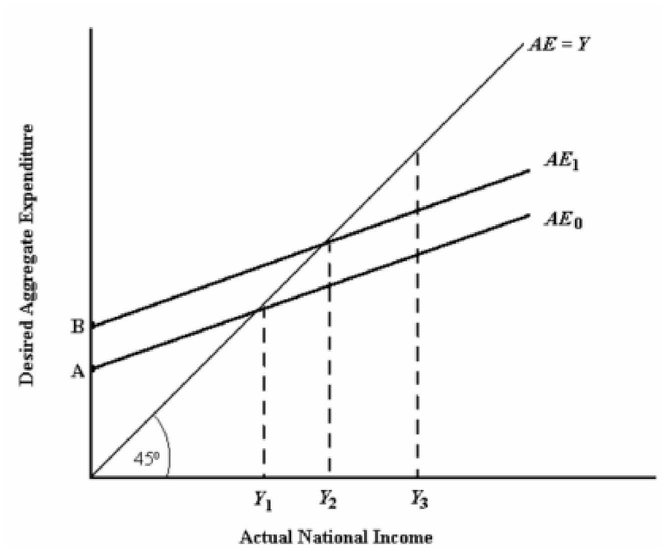



**Figure 12**

12. According to Figure 12, if national income is $Y_1$, and aggregate expenditure is $AE_1$, then desired aggregate expenditure
    A. exceeds income and income must rise.
    B. exceeds income and income must fall.
    C. is less than income and income must rise.
    D. is equal to income and income will not change.
    E. is less than income and income must fall.

13. The multiplier can be defined as
    A. national income divided by aggregate expenditure.
    B. the change in equilibrium national income divided by the initial change in autonomous expenditure that brought it about.
    C. the change in national income resulting from a change in expenditure, multiplied by the number of years since the initial change.
    D. a change in aggregate expenditures multiplied by the equilibrium level of national income.
    E. the change in national income resulting from a change in saving.

14. In a simple model of the economy, with no government and no foreign trade, the difference between actual national income and desired aggregate expenditure equals
    A. consumption minus savings.
    B. consumption minus desired investment.
    C. desired investment.
    D. savings.
    E. savings minus desired investment.

15. If net exports is greater than zero an economy is
    A. accumulating foreign assets.
    B. depleting foreign assets.
    C. not investing.
    D. not saving.
    E. taxes must equal government expenditure.

16. Suppose $G = 400$ and the income-tax rate is 20 percent. Government saving is negative for all values of $Y$
    A. above 10 000.
    B. above 8 000.
    C. above 2 000.
    D. below 8 000.
    E. below 2 000.

17. Suppose there is a decrease in aggregate demand and, simultaneously, an increase in short run *AS*. The result will be a
    A. rise in real GDP but price level changes will be indeterminate.
    B. rise in real GDP and a rise in the price level.
    C. rise in real GDP and a fall in the price level.
    D. an indeterminate change in real GDP and a rise in the price level.
    E. an indeterminate change in real GDP and a fall in the price level.

18. When wage rates rise faster than the increase in labour productivity the
    A. the *AD* curve shifts left.
    B. short run *AS* curve shifts upward.
    C. long run *AS* curve shifts right.
    D. long run *AS* schedule shifts left.
    E. short run *AS* curve shifts downward.

19. An important policy conclusion of the Phillips curve is that
    A. the real GDP can be maintained above the potential output without causing inflation.
    B. the unemployment rate can be maintained at less than the natural rate in the long run.
    C. an attempt to maintain real GDP higher than the potential output will result in accelerating inflation.
    D. fiscal policy is most effective in controlling inflation.
    E. maintaining real GDP greater than potential GDP results in a constant level of prices.

20. Demand-shock inflation is usually associated with major wars because the
    A. government must raise taxes to finance the war.
    B. large increase in government spending is not matched by an equivalent drop in private consumption expenditure.
    C. drop in the labour force because of the manpower needs of the armed forces causes shortages of labour.
    D. government spending for social programs must be reduced to finance the increase in military spending.
    E. prices always rise during a crisis.

21. When an economy experiences continuous growth in real GDP
    A. actual GDP is greater than potential GDP.
    B. actual GDP is less than potential GDP.
    C. potential GDP is likely to be increasing.
    D. factor prices are likely to be decreasing.
    E. wage rates will decrease slowly as as factor utilization rates decrease.

22. According to neoclassical growth models, an increase in the demand for investment causes
    A. a decrease in private savings and in the long-run increases the standard of living.
    B. an increase in private savings and in the long-run decreases the standard of living.
    C. a decrease in the interest rate and increases the long-run increases the standard of living.
    D. an increase in the interest rate and increases the long-run increases the standard of living.
    E. a decrease in national public savings.

23. Continued economic growth would be fostered by
    A. expansionary fiscal policy.
    B. decreasing excise taxes on consumer goods.
    C. technical change embodied in physical or human capital.
    D. elimination of an output gap.
    E. expansionary monetary policy.

24. Fiat money is valuable because it
    A. can be manufactured at will by the issuing government.
    B. has intrinsic value equal to its face value.
    C. is fully backed by gold at a fixed ratio.
    D. is only fractionally backed by gold.
    E. is generally accepted.

25. Suppose the economy is at full employment and the *AS* curve shifts upward due to a one-time increase in the price of oil. If the money supply is held constant,
    A. prices will rise and stay at the higher level with no further inflation.
    B. a recessionary gap will be created, which will eventually cause the *AS* curve to shift downward.
    C. aggregate demand will shift up and cause further inflation.
    D. an inflationary gap will be created, which will cause the *AS* curve to shift upward again.
    E. a recessionary gap will be created and will cause a permanent reduction of employment.

26. If the actual unemployment rate is equal to NAIRU, then
    A. actual and potential GDP are equal.
    B. actual GDP will be higher than potential GDP.
    C. actual GDP will be below potential GDP.
    D. potential GDP will expand permanently.
    E. none of the above

27. High taxes needed to cover interest on a growing national debt put a strain on government policies because
    A. expenditure on existing programs must increase to keep the proper balance with the growing interest payments on the debt.
    B. it diverts government revenue away from planned government expenditures and other transfers.
    C. the budget deficit complicates the Bank of Canada's anti-unemployment policy.
    D. the Bank of Canada finds it difficult to maintain a high interest rate policy in the face of large government deficits.
    E. the resulting deflation will push interest rates higher causing additional national debt.

28. If Canadian purchases of foreign assets were $100 million, Canadian loans to foreigners were $50 million, foreign purchases of Canadian assets were to $75 million, and foreign loans to Canadians were $35 million, then the capital account balance is equal to
    A. plus $90 million.
    B. plus $40 million.
    C. minus $10 million.
    D. minus $40 million.
    E. minus $90 million.

29. A decrease in desired investment is predicted to influence equilibrium income by causing
    A. a downward shift of the saving function.
    B. a downward shift of the consumption function.
    C. a downward shift of the aggregate expenditure function.
    D. a rightward movement along the investment function.
    E. an upward shift of the saving function.

30. An increase in the income-tax rate causes the *AE* curve to
    A. shift parallel downward.
    B. shift parallel upward.
    C. rotate downward.
    D. rotate upward.
    E. remain stationary.

31. Some economists argue that monetary policy is ineffective because, in the *long run*, it has no effect on
    A. nominal GDP.
    B. real GDP.
    C. nominal interest rates.
    D. the price level.
    E. the inflation rate.

32. The opportunity cost of holding money rather than bonds is
    A. the rate of interest on bonds.
    B. the price level.
    C. forgone consumption.
    D. forgone liquidity.
    E. zero.

33. The policy targets toward which monetary policy is directed include
    A. an equitable distribution of income.
    B. real national income and the price level.
    C. the efficient use of resources.
    D. the share of national income going to the owners of capital.
    E. the slope of the short run *AS* curve.

34. The idea of requiring the cyclically adjusted deficit to be zero at all times is problematic because
    A. this would act as a built-in destabilizer.
    B. this would entail a rising debt-to-GDP ratio.
    C. this would tend to mean that net exports would be crowded out.
    D. this would work poorly if peaks and troughs were wrongly predicted.
    E. all of the above

35. Real national income
    A. always equals nominal national income.
    B. changes by the same amount and in the same direction as does nominal national income.
    C. changes only when output quantities change.
    D. refers to national income with no adjustment for changes in prices.
    E. refers to national wealth but is not an indicator of current production.

36. A fall in the price level ________ the real value of money holdings, while a rise in the price level ________ the real value of money holdings.
    A. raises; lowers
    B. lowers; does not affect
    C. lowers; raises
    D. does not affect; lowers
    E. does not affect; raises

37. Increases in real GDP in the short run that may actually decrease the long run growth rate are associated with
    A. decrease in savings in the short run
    B. decrease in factor productivity.
    C. increase in factor utilization rates in the short run.
    D. increase in factor supply.
    E. increase in the unemployment rate.

38. If a richer country GDP per capita grows at a faster annual rate than a poorer one
    - A. the gap between their standards of living will widen over time.
    - B. the gap between their standards of living will close over time.
    - C. the gap between their standards of living will close over time as long as the rate of population growth is higher in the poorer country.
    - D. whether the gap in living standards widens or closes over time depends on the absolute size of the relative growth rates.
    - E. the difference in their living standards will not change over time.

39. If there are just two assets, bonds and money, then an excess demand for money implies
    - A. an excess supply of bonds.
    - B. an excess demand for bonds.
    - C. equilibrium in the bond market.
    - D. a indeterminant disequilibrium in the bond market.
    - E. nothing about conditions of demand for the other financial asset.

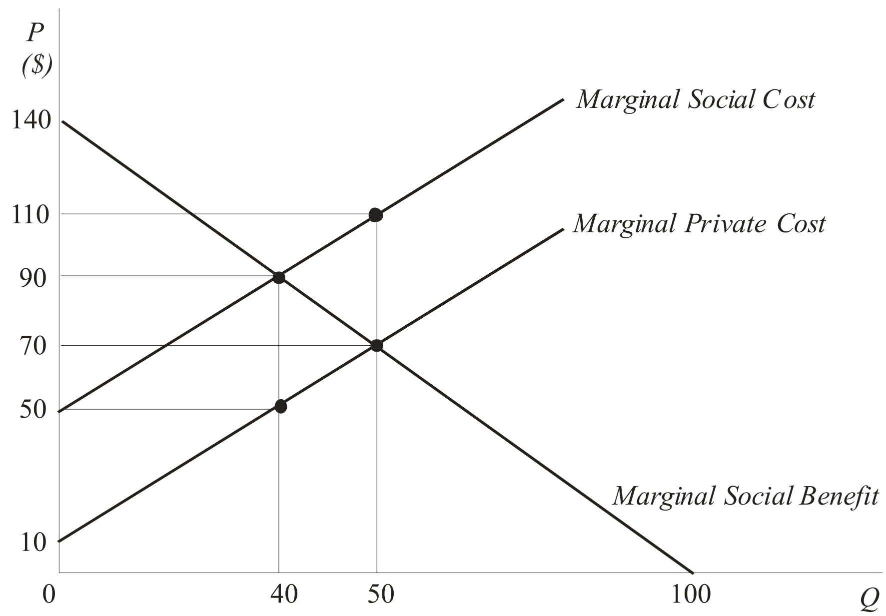
40. Autonomous expenditures are
    - A. dependent on national income.
    - B. not dependent on national income.
    - C. induced expenditures.
    - D. those which automatically occur.
    - E. non-domestic expenditures.

***Part B*** [8 marks]

The following 8 questions (41-48) relate to the information given below. Try to do the questions in order since the answers for some questions depend on the answers to previous questions in the series.

Each question is worth 1 mark.

The following diagram illustrates the competitive market for the good Q.




Use the space below for any calculations you may need to make.

41. Based on the diagram, unregulated production and sale of good Q involves:
    A. a negative externality in production.
    B. a positive externality in consumption.
    C. a positive externality in production.
    D. a non-rivalrous good problem.
    E. a socially optimal situation.

42. In equilibrium the price of good Q will be:
    A. 50
    B. 70
    C. 90
    D 110
    E. 140

43. At a social optimum the quantity of good Q produced is:
    A. impossible to determine from the diagram.
    B. 0
    C. 40
    D. 50
    E. 100

44. The deadweight loss associated with the competitive output level is equal to:
    A. 0
    B. 200
    C. 400
    D. 1600
    E. 2000

45. Suppose the government imposes a specific tax on output to restore efficiency to this market. The level of the tax should be ___ per unit of output.
    A. 0
    B. 20
    C. 40
    D. 60
    E. 90

46. The total direct burden associated with this optimal tax will be:
    A. 0
    B. 40
    C. 800
    D. 1000
    E. 1600

47. Suppose that production of each unit of output creates 10 units of pollution. The government decides not to place a tax on output, but instead institutes a system of tradable permits that give the holders the right to produce one unit of pollution. If the government issues the optimal number of permits, there will be ______ permits and they will trade at a price of _____.
    A. 40, $40
    B. 400, $4
    C. 500, $2
    D. 400, $2
    E. 500, $4

48. The advantage of the tradable permit system over the tax system is that:
    A. it leads to a better social outcome than the tax system.
    B. it ensures that each company produces where marginal social cost equals marginal social benefit, but the tax system does not.
    C. it increases government revenue above that available under the tax system.
    D. it provides better long-run incentives for emissions reduction than does the tax system.
    E. it may be easier to implement politically since firms pay less tax.

**Part C** [8 marks]

The following 8 questions (49-56) relate to the information given below. Try to do the questions in order since the answers for some questions depend on the answers to previous questions in the series.

Each question is worth 1 mark.

Suppose the table below represents the 2005 and 2006 final goods output of an economy that produces only two goods.

| **2005** | ***Price per Unit*** | ***Number of Units*** |
|---|---|---|
| ***Good A*** | $1.00 | 400 |
| ***Good B*** | $3.00 | 200 |

| **2006** | ***Price per Unit*** | ***Number of Units*** |
|---|---|---|
| ***Good A*** | $0.75 | 480 |
| ***Good B*** | $4.00 | 180 |

The space below is provided for you to work out and keep track of your answers as you work through the series.

49. Nominal GDP in 2006
    A. is equal to 1000.
    B. is equal to 1020.
    C. is equal to 1080.
    D. is equal to 1100.
    E. cannot be determined from the information given.

50. If 2005 is the base year, real GDP in 2006
    A. is equal to 1000.
    B. is equal to 1020.
    C. is equal to 1080.
    D. is equal to 1100.
    E. cannot be determined from the information given.

51. Now suppose that the data in the table represents not the output of the whole economy, but rather the average household consumption bundles for the two years. If 2005 is the base year, the consumer price index (CPI) for 2006
    A. is equal to 100
    B. is equal to 102
    C. is equal to 108
    D. is equal to 110
    E. cannot be determined from the information given.

52. The inflation rate in the CPI between 2005 and 2006 is equal to ___.
    A. 10%
    B. 8%
    C. 2%
    D. 0%
    E. 110%

53. Suppose the inflation rate in 2006 becomes expected for 2007. If actual inflation is higher in 2007 than expected,
    A. creditors are made worse off and debtors are made better off.
    B. creditors are made better off and debtors are made worse off.
    C. both creditors and debtors are made worse off.
    D. both creditors and debtors are made better off.
    E. neither creditors nor debtors are affected.

54. If actual inflation is higher in 2007 than expected, and the economy was originally in long run equilibrium,
    A. GDP will decrease because real wages will rise.
    B. GDP will decrease because real wages will fall.
    C. GDP will be unaffected because real wages will be unaffected.
    D. GDP will increase because real wages will rise.
    E. GDP will increase because real wages will fall.

55. If actual inflation is higher than expected in 2007, in the future,
   A. nominal wages will rise shifting the short run aggregate supply curve down and to the right.
   B. nominal wages will rise shifting the short run aggregate supply curve up and to the left.
   C. nominal wages will fall shifting the short run aggregate supply curve down and to the right.
   D. nominal wages will fall shifting the short run aggregate supply curve up and to the left.
   E. nominal wages and the short run aggregate supply curve to be unaffected.

56. If actual inflation is higher than expected in 2007,
   A. expected inflation for future years will be unaffected.
   B. expected inflation for future years will increase so actual inflation in future years will likely decrease.
   C. expected inflation for future years will increase so actual inflation in future years will likely increase.
   D. expected inflation for future years will decrease so actual inflation in future years will likely decrease.
   E. expected inflation for future years will decrease so actual inflation in future years will likely increase.

***Part D*** [8 marks]

The following 8 questions (57-64) relate to the information given below. Try to do the questions in order since the answers for some questions depend on the answers to previous questions in the series.

Each question is worth 1 mark.

Consider the following model of a closed economy. Output prices, factor prices and interest rates are assumed constant. We have the following information:

| | |
|---|---|
| Consumption: | $C = 100 + (0.80)Y_D$ |
| Investment: | $I = 100$ |
| Government Spending | $G = 200$ |
| Taxes (net of transfers) | $T = (0.25)Y$ |

where $Y_D$ is disposable income and $Y$ is national income.

The space below is provided for you to keep track of your answers as you work through the series of questions. [Hint: You may want to sketch an *AE* diagram to help with this process.]

57. The equation for aggregate expenditure is given by:
    A. $AE = 100 + (0.8)Y$.
    B. $AE = 100 + (0.6)Y$.
    C. $AE = 400 + (0.2)Y$.
    D. $AE = 400 + (0.6)Y$.
    E. $AE = 400 + (0.8)Y$

58. The equilibrium level of national income is:
    A. 250.
    B. 500.
    C. 1000.
    D. 1600.
    E. 2000.

59. In equilibrium, the government:
    A. pays more in transfers than it receives in taxes.
    B. is running a surplus.
    C. is running a deficit
    D. has a balanced budget.
    E. could be doing any of the above, there is not enough information to be sure.

60. In equilibrium, government saving plus private saving will be equal to:
    A. 0.
    B. 50.
    C. 100.
    D. 200.
    E. 400.

61. Suppose that government spending increases from 200 to 280. In the new equilibrium the government :
    A. will be running a deficit of 30.
    B. will be running a surplus of 20.
    C. will be running a surplus of 50.
    D. will have a balanced budget.
    E. could be doing any of the above, there is not enough information to be sure.

62. In the new equilibrium, government saving plus private saving will be equal to:
    A. 0.
    B. 50.
    C. 100.
    D. 200.
    E. 400.

Suppose government spending is at the original level of 200 and the economy opens up to foreign trade. Suppose that this foreign trade sector is described by:

Exports: $X = 100$

Imports: $IM = (0.10)Y$

(Note that imports are a function of national Income, not disposable income.)

63. In this now open economy, equilibrium national income is equal to:
    A. 250.
    B. 500.
    C. 1000.
    D. 1600.
    E. 2000.

64. In equilibrium, National Asset Accumulation is:
    A. 0.
    B. 50.
    C. 100.
    D. 200.
    E. 400.

***Part E*** [8 marks]

The following 8 questions (65-72) relate to the information given below. Try to do the questions in order since the answers for some questions depend on the answers to previous questions in the series.

Each question is worth 1 mark.

The table below represents the banking system for a particular economy. Individuals and the government hold all their money in the bank. Figures are in millions of dollars.

| **Assets:** | | **Liabilities:** | |
|---|---|---|---|
| Reserves | 100 | Private deposits | 1950 |
| Government bonds | 100 | Government deposits | 50 |
| Outstanding loans | 1900 | Owners' capital | 100 |
| **Total** | 2100 | **Total** | 2100 |

Use the space below to keep track of your answers as you work through the series.

65. The size of the money supply is:
    A. 50 million
    B. 100 million
    C. 150 million
    D. 2000 million
    E. 2100 million

66. Assuming this banking system is in equilibrium, the desired reserve ratio is:
    A. 1/21
    B. 1/20
    C. 1/18
    D. 1/1
    E. 2/1

67. The government holds deposits in the Central bank as well in the commercial banking system. Suppose the central bank moves 100 million of its government deposits to the commercial banking system. On that day the level of reserves in the commercial banking system will be:
    A. 0
    B. 100 million
    C. 150 million
    D. 200 million
    E. 2000 million

68. On that same day, the level of the money supply will be:
    A. 150 million
    B. 200 million
    C. 2000 million
    D. 2100 million
    E. 4000 million

69. Assuming that the commercial bank desires to maintain its reserve ratio, in equilibrium the level of outstanding loans and the level of the money supply will be _______:
    A. loans 1900 million, money supply 2000 million
    B. loans 3800 million, money supply 4000 million
    C. loans 3800 million, money supply 3700 million
    D. loans 4000 million, money supply 4000 million
    E. loans 4000 million, money supply 4300 million

70. Suppose this is an open economy with flexible foreign exchange rates and the demand for money is *inelastic* with respect to interest rates (not very responsive to changes in the interest rate). Then this policy will:
    A. reduce interest rates, reduce investment, and reduce net exports.
    B. reduce interest rates, increase investment, and reduce net exports.
    C. reduce interest rates, reduce investment, and increase net exports.
    D. reduce interest rates, increase investment, and increase net exports.
    E. have no great effect on interest rates, investment, or net exports.

71. Suppose the economy is in a deep recession and the demand for money is highly *elastic* with respect to interest rates (is very responsive to changes in the interest rate). Then this policy will:
    A. be highly effective in reducing interest rates in the short-run.
    B. raise prices and real income in the short run.
    C. have no great effect on real income or prices in the short run.
    D. raise real income without raising prices in the short run.
    E. raise prices without affecting real income in the short run.

72. Suppose the economy is at long run potential output and the demand for money is *inelastic* with respect to interest rates (not very responsive to changes in the interest rate). This policy will:
    A. raise prices and reduce real income in the long run.
    B. raise prices and real income in the long run.
    C. have no great effect on real income or prices in the long run.
    D. raise real income without raising prices in the long run.
    E. raise prices without affecting real income in the long run.

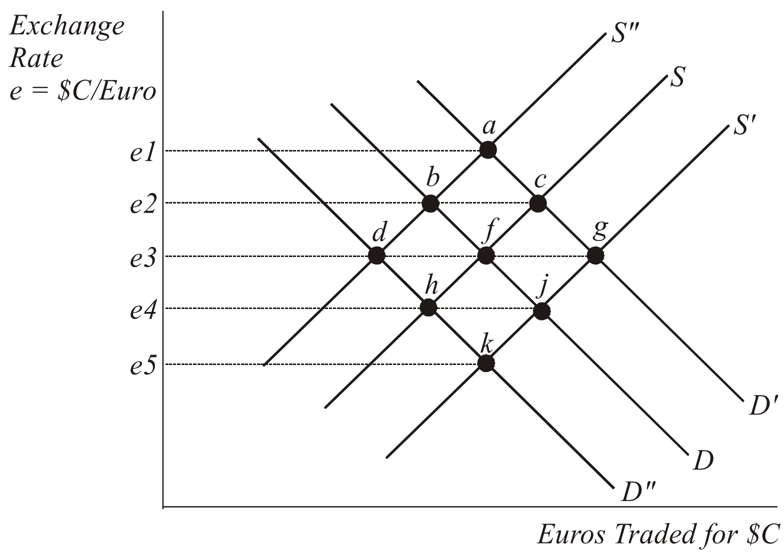
***Part F*** [8 marks]

The following 8 questions (73-80) relate to the information given below. Try to do the questions in order since the answers for some questions depend on the answers to previous questions in the series.

Each question is worth 1 mark.

The diagram below represents the foreign exchange market. The horizontal axis measures the quantity of Euros traded for Canadian dollars ($C) and the vertical axis measures the exchange rate, the number of $C per Euro.

Assume that the market is in the equilibrium represented by point "***f***", and that (at least initially) the exchange rate between the Canadian dollar and the Euro is fully flexible.




73. The supply curve of Euros for Canadian dollars is upward sloping because, as ***e*** rises,
    A. the Canadian dollar appreciates so Europeans want to purchase fewer exports from Canada.
    B. the Canadian dollar depreciates so Europeans want to purchase fewer exports from Canada.
    C. the Canadian dollar appreciates so Europeans want to purchase more exports from Canada.
    D. the Canadian dollar depreciates so Europeans want to purchase more exports from Canada.
    E. the Canadian dollar appreciates so Canadians want to purchase more exports from Europe.

74. At the initial equilibrium point ***f***,
    A. the current account balance plus the capital account balance is positive.
    B. the current account balance plus the capital account balance is negative.
    C. the current account balance plus the capital account balance is zero.
    D. the balance on the official financing account at the Bank of Canada is positive.
    E. the balance on the official financing account at the Bank of Canada is negative.

***For the balance of the series suppose that interest rates in Europe increase relative to those in Canada, and that Canada is operating with flexible exchange rates.***

75. The new exchange rate will be ___ and the new equilibrium will be at the ___.
    A. *e2;* point *b*.
    B. *e1;* point *a*.
    C. *e3;* point *d*.
    D. *e5;* point *k*.
    E. *e4;* point *j*.

76. As a result of the change in European interest rates,
    A. the Canadian dollar depreciates and Canadian net exports to Europe will increase.
    B. the Canadian dollar depreciates and European net exports to Canada will increase.
    C. the value of the Canadian dollar is unchanged so Canadian net exports to Europe will be unchanged.
    D. the Canadian dollar appreciates and Canadian exports to Europe will decrease.
    E. the Canadian dollar appreciates and European net exports to Canada will increase.

77. As a result of the change in European interest rates, in Canada
    A. the short run aggregate supply curve shifts left.
    B. the short run aggregate supply curve shifts right.
    C. neither the short run aggregate supply curve nor the aggregate demand curve are affected.
    D. the aggregate demand curve shifts left.
    E. the aggregate demand curve shifts right.

78. If Canada was initially running a current account surplus, then the change in European interest rates will
    A. decrease the amount of the current account surplus.
    B. have no effect on the amount of the current account surplus.
    C. increase the amount of the current account surplus.
    D. change the amount of the current account surplus but we cannot tell whether it would rise or fall.
    E. cause the current account to fall into deficit.

79. As a result of the increase in European interest rates, Canada will
    A. not change its net borrowing from the rest of the world.
    B. increase its net borrowing from the rest of the world.
    C. decrease its net borrowing from the rest of the world.
    D. increase its net lending to the rest of the world.
    E. decrease its net lending to the rest of the world.

80. If the Bank of Canada wanted to fix the exchange rate at the original level in the face of the change in European interest rates, it would have to
    A. do nothing since the exchange rate does not change.
    B. sell Euros equal to distance *dg*.
    C. sell Euros equal to distance *df*.
    D. purchase Euros equal to distance *dg*.
    E. purchase Euros equal to distance *df*.

**W07 – 110 Answers:**

**Part A**

| | | | |
|---|---|---|---|
| 1. C | 11. D | 21. C | 31. B |
| 2. A | 12. A | 22. D | 32. A |
| 3. A | 13. B | 23. C | 33. B |
| 4. C | 14. E | 24. E | 34. D |
| 5. D | 15. A | 25. B | 35. C |
| 6. E | 16. E | 26. A | 36. A |
| 7. E | 17. E | 27. B | 37. A |
| 8. D | 18. B | 28. D | 38. A |
| 9. A | 19. C | 29. C | 39. A |
| 10. B | 20. B | 30. C | 40. B |

| **Part B (110)** | | **Part C** | | **Part D** | | **Part E** | | **Part F** | |
|---|---|---|---|---|---|---|---|---|---|
| 41. | A | 49. | C | 57 | D | 65 | D | 73. | D |
| 42. | B | 50. | B | 58 | C | 66 | B | 74. | C |
| 43. | C | 51. | D | 59 | B | 67 | D | 75. | B |
| 44. | B | 52. | A | 60 | C | 68 | D | 76. | A |
| 45. | C | 53. | A | 61 | B | 69 | B | 77. | E |
| 46. | E | 54. | E | 62 | C | 70 | D | 78. | C |
| 47. | B | 55. | B | 63 | C | 71 | C | 79. | D |
| 48. | E | 56. | C | 64 | C | 72 | E | 80. | B |