Economics 102

FINAL EXAM

PLEASE NOTE:

The exam has 4 parts. Each of the 4 parts is of equal value. Total time: 2 hours.

Answer the last part (Part D) on the sheet provided.

For each of the other 3 parts (A through C), PLEASE USE A SEPARATE EXAM BOOK FOR EACH PART; i.e., submit a total of 3 exam books. On the outside of each book please put (a) your name, (b) your TA’s name, and (c) the question (A,B, or C) being answered.

PART A (30 minutes)

The falling dollar ... is just what the doctor ordered for a weak American economy. ...The main problem is that what is good for American manufacturers is bad for European manufacturers. ... Ideally, Europe should be cutting interest rates to support demand at home.

(1) In the two country (Britain and America) two currency (pounds and dollars) example we used to investigate how foreign exchange markets work, explain why the demand for pounds by Americans planning to travel to Britain slopes downward to the right.

(2) Why is a falling dollar good for a weak American economy?

(3) Why is a falling dollar bad for European manufacturers?

(4) If European interest rates are cut to levels below American interest rates, what will be the effect on the value of the dollar? on the U.S. economy? (If you use symbols and causal arrows in your answer, be sure to define each symbol used.)
PART B (30 minutes)

Productivity, measured as output per hour worked, is not rising fast enough to offset the growth in wages and benefits. As a result, the labor cost of producing a unit of output - whether it’s a new car, a stock trade, or a haircut - is rising much faster than prices. This implies increasing pressure on companies to raise prices to cover those higher costs or a growing squeeze on profit margins - or both.

(1) (a) What are the three main types of inflation?
(b) Which type of inflation is being described in the above quotation?

(2) (a) Which of these three types of inflation can be substantially reduced by the effective use of monetary policy?
(b) For each type of inflation you note (in answer to 2[a]) explain how an effective use of monetary policy would reduce inflationary pressures. Again, if you use symbols and causal arrows in any part of your answer, be sure each symbol used is defined.

(3) How was the inflation described in the quotation effectively combated in the early 1980s? Describe the policies used and why they were successful.

PART C (30 minutes)

Explain the relationship between EACH of the following pairs. In most cases, to explain the relationship you will need to begin by defining the concepts involved.

(1) value added AND gross domestic product (GDP)
(2) the Phillips Curve AND the natural rate of unemployment
(3) full employment AND production possibilities frontier
(4) private savings AND economic growth