

Summer 2020 – Final Assessment – (20%)

ECON252 – Macroeconomics-

Name	ID

Final assessment *submission* deadline is 5 days. The deadline for submission is 27 September.

A delay in assessment submission will result in the following grade deduction:

- Delay of 1 Day: 10% Deduction
- Delay of 2 Days: 20% Deduction
- Delay of 3 Days: 40% Deduction
- Delay of 4 Days: 50% Deduction
- Delay of 5 Days: 100% Deduction



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Multiple Choice answer sheet

Questions	Choice of answer			
1	A	B	C	D
2	A	B	C	D
3	A	B	C	D
4	A	B	C	D
5	A	B	C	D
6	A	B	C	D
7	A	B	C	D
8	A	B	C	D
9	A	B	C	D
10	A	B	C	D



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SECTION [1] MULTIPLE CHOICE QUESTIONS [20%]

INSTRUCTIONS:

- 1- ANSWER ALL QUESTIONS.**
- 2- EACH QUESTION IS WORTH TWO MARKS.**

- 1) The multiplier effect exists because a change in autonomous expenditure
- A) leaves the economy in the form of imports.
- B) leads to changes in income, which generate further spending.**
- C) will undergo its complete effect in one round.
- D) prompts further exports.
- 2) Fiscal policy is defined as changes in _____ and _____ to achieve macroeconomic objectives such as price stability, high rates of economic growth, and high employment.
- A) taxes; expenditures** B) interest rates; money supply C) taxes; the money supply D) taxes; interest rates
- 3) If the economy is growing beyond potential real GDP, which of the following would be an appropriate fiscal policy to bring the economy back to long-run aggregate supply? An increase in
- A) the money supply and a decrease in interest rates.**
- B) oil prices.
- C) taxes.
- D) government purchases.
- 4) Saving equals
- A) disposable income minus consumption expenditure.**
- B) consumption expenditure minus disposable income.
- C) disposable income plus consumption expenditure.
- D) disposable income minus taxes
- 5) Long-run macroeconomic equilibrium occurs when
- A) structural and frictional unemployment equals zero.
- B) output is above potential GDP.
- C) aggregate demand equals short-run aggregate supply and they intersect at a point on the long-run supply curve.**
- D) aggregate demand equals short-run aggregate supply.
- 6) If the Central Bank and the government agree to apply contractionary policies simultaneously, what will be the unwanted effect?
- A) severe deflation
- C) very high unemployment**
- B) very high inflation
- D) very low unemployment



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7) If the multiplier is 6 and exports decrease by \$30, what impact will that have on aggregate expenditure?

A) decrease by \$180

B) increase by \$180

C) increase by \$30

D) decrease by \$30

8) The level of aggregate supply in the long-run is *not* affected by

A) changes in technology.

B) changes in the number of workers.

C) changes in the capital stock.

D) changes in the price level.

9) An increase of the tax on business income will reduce aggregate demand because

A) consumption spending will fall B) government spending will fall C)

investment spending will fall D) wages will increase

10) When the price level in Kuwait rises relative to the price level of other countries, _____ will fall and _____ will fall.

A) exports; imports

B) exports; net exports

C) imports; net exports

D) net exports; imports



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SECTION [2] PROBLEM SOLVING [60%]

INSTRUCTIONS:

- 1- ANSWER ALL QUESTIONS.
- 2- EACH QUESTION IS WORTH SEVEN AND HALF MARKS WITH TOTAL FIFTEEN MARKS FOR EACH PROBLEM.

Problem 1 (15%)

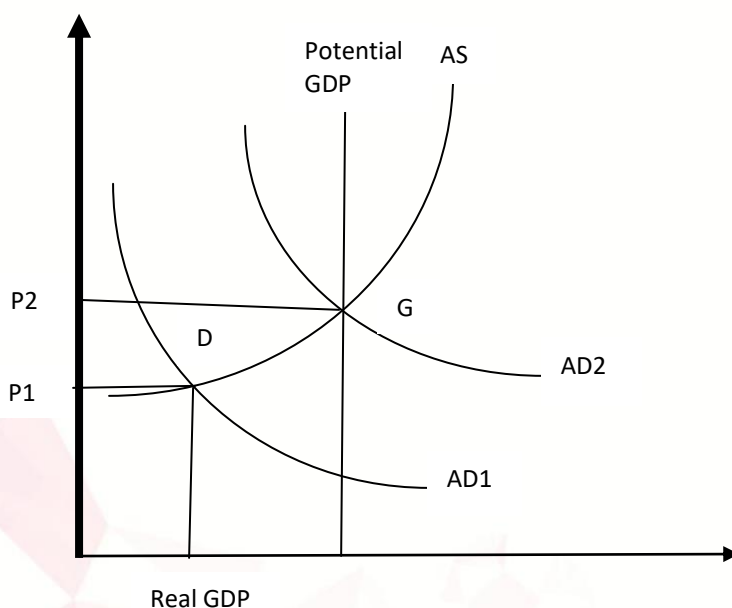
Government plans to apply fiscal policy in 2017.

Year	Actual Real GDP	Potential GDP	Price Level
2018	KD 16.0 billion	KD 16.0 billion	100
2019	KD 15.4 billion	KD 16.0 billion	90

Answer the below questions:

1. Which fiscal policy will be applied (contractionary or expansionary)? Explain why and discuss its effects on production, employment and prices (use a graph to better explain the mechanism).

The expansionary fiscal policy should be applied. The government should increase its spending and cut down taxes. This will put upward pressure on the level of price hence increase output.



Increasing the price level from P1 to P2 will increase the aggregate demand from D to G hence real GDP will be equal to potential GDP.

2. Calculate by how much government should change taxes to reach equilibrium, if tax multiplier is equal to -3 in this economy. Show your calculations.

$$\text{Tax multiplier} = - \text{MPC} / (1 - \text{MPC})$$

$$\text{MPC} = 3$$

$$\text{MPC} = \frac{\text{consumption change}}{\text{income change}}$$
$$3 = \frac{\text{change in consumption}}{(16\text{b} - 15.4\text{b})}$$
$$\text{Change in consumption} = 0.6 \text{ billion} * 3$$
$$= 1.8 \text{ billion}$$

The government should reduce taxes by 1.8 billion.

3. Will a change in Government purchases be a better or worse decision? Why? Explain the mechanism.

A change in purchases made by the government will be a worse decision. Increase in purchases will lead to reduced price levels due to low demand. This will worsen the situation as the real GDP will fall lower further than the present condition.



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Problem 2 (15%)

Year	Actual Real GDP	Potential GDP	Price Level	Unemployment
2018	KD 13.4 billion	KD 13.4 billion	100	17 %
2019	KD 14 billion	KD 13.4 billion	106	6%

1. Describe country's macroeconomic condition in these two years in terms of macroeconomic equilibrium and business cycle. What happened in the economy in 2019?

The country experienced an inflationary gap in 2019. An increase in the price level from 100 in 2018 to 106 in 2019 resulted in decrease in the level of unemployment from 17% to 6% boosting the real GDP up from 13.4 billion in 2018 to 14 billion in 2019. The country thus experienced an economic expansion in 2019.

2. If the government purchases multiplier is 4 and the tax multiplier is -2,

- a) By how much will government purchases need to be changed to bring the economy to equilibrium at potential GDP?

From the purchases multiplier, $MPC = 4$

$4 = \text{change in government purchases} / 600$

Change in purchases will be 2400.

- b) By how much will taxes have to be changed to bring the economy to equilibrium at potential GDP?

From the tax multiplier, $MPC = 2$

$2 = \text{change in taxes} / 600$

Change in taxes will be 1200.



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Problem 3 (15%)

The below information shows that economy needs corrective actions by the Central Bank, which decided to use monetary policy.

Year	Actual Real GDP	Potential GDP	Price Level
2020	KD 15.2 billion	KD 15.6 billion	104

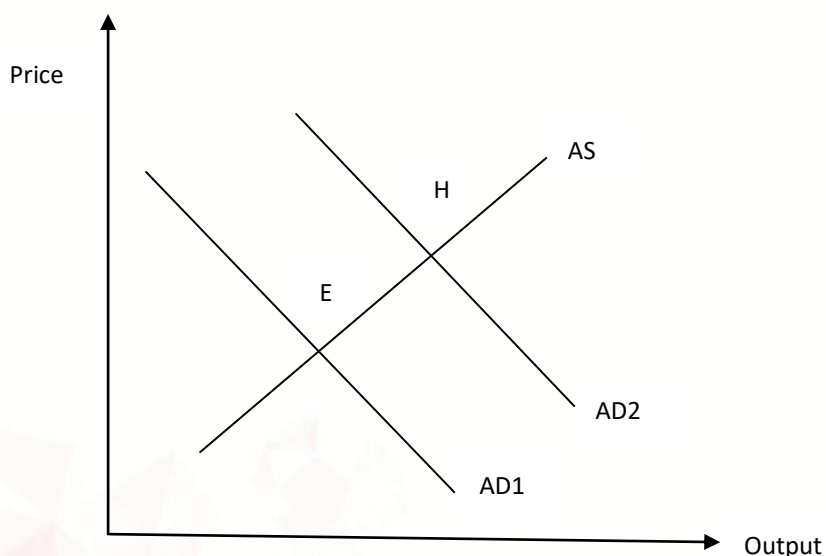
Answer the below questions:

1. Define what is a monetary policy, how is it conducted and who is responsible of its implementation.

A monetary policy is an action taken by the central bank of a country that aims at controlling the price levels in that economy. The central bank increases or decreases the interest rates and the price of money to control the demand and supply of money in the economy. The action is implemented by the subsidiary banks.

2. If the Central Bank wants to keep real GDP at its potential level, should it use an expansionary or a contractionary monetary policy? Use a graph with aggregate demand and aggregate supply to explain answer.

The central bank will use an expansionary monetary policy that will increase consumption and thus increase aggregate expenditure from point E to H.



3. **Explain** the mechanism of that policy. (explain how tools need to be applied)

The central bank will decrease the rates of interest. Decreased rates of interest will encourage borrowing and increased investments. The disposable income will also increase thus increasing consumption levels.



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Problem 4 (15%)

AE	GDP
8520	8400
	8600
8840	
9000	9000
	9200
9320	
9480	9600

- 1) Using the information given in the table above, calculate the MPC and MPS and the multiplier. Show your calculations.

$$\text{MPC} = (9480 - 8520) / (9600 - 8400)$$

$$= 960 / 1200$$

$$= 0.8$$

$$\text{MPS} = 1 - \text{MPC}$$

$$= 1 - 0.8$$

$$= 0.2$$

$$\text{Multiplier} = -\text{MPC} / (1 - \text{MPC})$$

$$= -0.8 / 0.2$$

$$= 4$$

- 2) If the net export increases by 600, what will be the new equilibrium in the economy. Show your calculations.

Increase in exports by 600 will increase income by the same amount.

That is, GDP + 600.

9000 + 600 = 9600. The new equilibrium will 9600.



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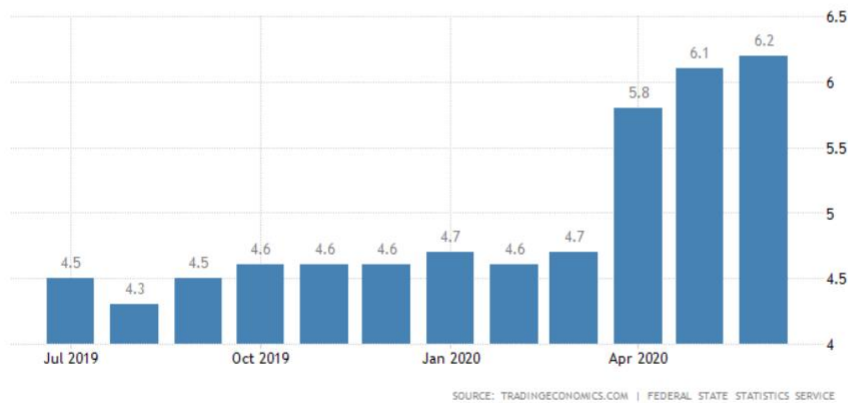
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SECTION [3] SHORT ESSAY [20%]

1- **WRITE YOUR ANSWER IN THE SPACE PROVIDED WITH CLEAR ARGUMENTS.**

2- **THE FORMAT WITH INTRODUCTION, BODY TEXT AND CONCLUSION**

Below is the graph from Tradingeconomics on the unemployment rate in Russia:



Now, if Russia wants to control inflation, your task is to:

1. Define the phase of the business cycle that Russia is going through.
Russia is undergoing the recession cycle of business since the level of unemployment is increasing thus the potential GDP is more than the real GDP and the resources are not fully exploited.
2. To choose the appropriate monetary and fiscal policies.
The government should employ expansionary fiscal and monetary policies that will boost expenditure thus increasing the aggregate demand.
3. To provide clear arguments using, AD and AS analysis, to show what are the similarities and difference between the selected monetary and fiscal policies (**Use the format with introduction, body text and conclusion**)



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Answer:

Both expansionary monetary and fiscal policies increase the level of AD and AS thus leading to increased real GDP while contractionary policies, both monetary and fiscal, reduce AD and AS shifting them to the left.

Fiscal policies include government actions on its spending and taxes while monetary policy involve actions by the central bank on supply of money and interest rates. Fiscal policies have no specific target on AD and AS while monetary policies are targeted on inflation.