

Name: _____

Quiz #2 Fall 2005

This is a closed book exam. You are required to abide all the rules of the Student Conduct Code of the University of Connecticut.

1. Net capital outflow is equal to:
 - A) national saving minus the trade balance.
 - B) domestic investment plus the trade balance.
 - C) domestic investment minus national saving.
 - D) national saving minus domestic investment.

2. Many economists attribute part of the recent increase in European unemployment to:
 - A) high birth rates.
 - B) slow rates of technological change.
 - C) generous benefits for unemployed workers.
 - D) increased demand for unskilled workers.

3. Transitions into and out of the labor force:
 - A) rarely occur.
 - B) do not affect unemployment statistics.
 - C) make unemployment statistics difficult to interpret.
 - D) reduce the amount of frictional unemployment.

4. The unemployment resulting from wage rigidity and job rationing is called _____ unemployment.
 - A) frictional
 - B) structural
 - C) minimum-wage
 - D) insider

5. Frictional unemployment is unemployment caused by:
- A) wage rigidity.
 - B) minimum-wage legislation.
 - C) the time it takes workers to search for a job.
 - D) clashes between the motives of insiders and outsiders.
6. In a large open economy, the real interest rate is determined by:
- A) national saving, the domestic investment function, and the net capital outflow function.
 - B) national saving, the domestic investment function, and the net-exports function.
 - C) the domestic investment function, the net capital outflow function, and the net-exports function.
 - D) national saving, the domestic investment function, the net capital outflow function, and the net-exports function.
7. Assume that some large foreign countries decide to subsidize investment by instituting an investment tax credit. Then the home country's real exchange rate:
- A) will fall and its net exports will rise.
 - B) will rise and its net exports will fall.
 - C) and net exports will both fall.
 - D) and exports will both rise.
8. Assume that in a small open economy with full employment, consumption depends only on disposable income. National saving is 300, investment is given by $I = 400 - 20r$, where r is the real interest rate in percent, and the world interest rate is 10 percent.
- a. If government spending rises by 100, does investment change? What is the level of investment after the change?
 - b. Does the trade balance change if G rises by 100? If it changes, does it increase or decrease, and by how much?
 - c. Does net capital outflow change if G rises by 100? If it changes, does it increase or decrease, and by how much?
 - d. Will the real exchange rate rise, fall, or remain constant as a result of the change in G ?

9. The government of a small open economy wishes to promote trade policies that will result in currency appreciation.
 - a. Would protectionist policies (higher tariffs and more quotas) or freer trade policies (tariff reductions and quota eliminations) be more effective in generating currency appreciation?
 - b. Illustrate graphically the impact of the trade policy on the exchange rate of the small open economy.
 - c. What will happen to the trade balance of the small open economy as a result of the trade policies, assuming that the country started from a position of free trade?
 - d. What will happen to the quantity of exports and imports as a result of the trade policies?

10.
 - a. In April 1995, Michel Camdessus, managing director of the International Monetary Fund (IMF), criticized U.S. economic policy for allowing the dollar exchange rate to fall too low. He recommended that the United States reduce its budget deficit in order to raise the exchange rate. Use the long-run model of a small open economy to illustrate graphically the impact of reducing the government's budget deficit on the exchange rate and the trade balance. Be sure to label: i. the axes; ii. the curves; iii. the initial equilibrium values; iv. the direction the curves shift; and v. the new long-run equilibrium values.

 - b. Based on your graphical analysis, explain whether Mr. Camdessus's policy recommendation will work. Specifically state what happens to the exchange rate and the trade balance as a result of the government budget deficit reduction.

11. If the economy were at a steady-state unemployment rate with a separation rate of 0.02 per month and a job-finding rate of 0.10 per month, and the labor force was 100 million, how many individuals would lose their jobs each month?

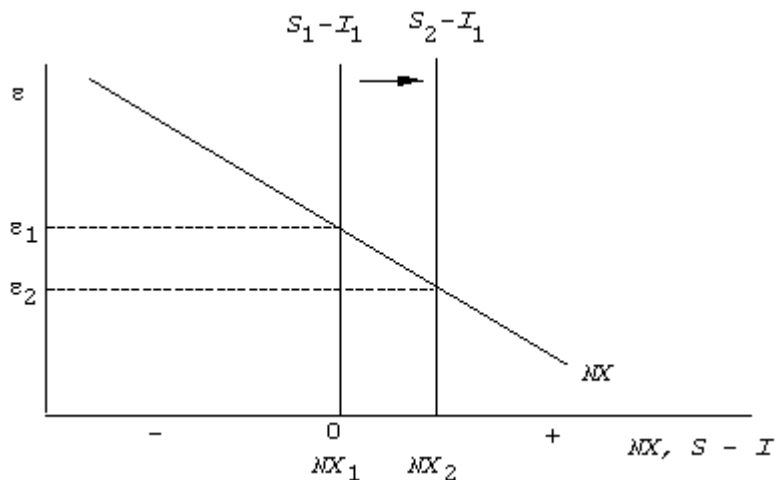
Answer Key

1. D
2. C
3. C
4. B
5. C
6. A
7. A
8. a. No. 200 b. Yes. It decreases by 100. c. Yes. It decreases by 100. d. It will rise.
9. a. Protectionist policies will result in currency appreciation.
b. The protectionist policies increase the demand for net exports.

c. The trade balance will remain unchanged--still balanced.

d. The volume of exports will decrease (as a result of the currency appreciation), and the volume of imports will decrease (as a result of the protectionist policies).

10. a.



b. Mr. Camdessus's policy will not have the intended effect. The dollar exchange rate will decline and the trade balance will move toward surplus.

11. 2 million

