University of Saskatchewan
ECON 214.3
Midterm Examination
February 26, 2008

Professor: Cristina Echevarria
Instructions:

- You can leave the room as soon as you finish the exam. Submit all booklets and keep this questionnaire.
- Time: 75 minutes
- Answer all questions. Questions are of equal worth.
- Calculators without a memory function are allowed. Other electronic devices (electronic translators, cell phones, ipods, ...) are not.
- Please write your name on all booklets.
- I *prefer* that you write your answers in pen.
- You can assume anything you need/want, but be sure to make explicit what you are assuming.
- Make sure to define the terms in **bold** in the questions.

1. National accounting. In 1989 **GDP** per capita in the United States exceeded US$21,000 per person. In the same year GDP per person was US$180 in Bangladesh, US$120 in Ethiopia and US$80 in Mozambique. Does this mean that the standard of living in the United States was 115 times as great as that in Bangladesh, 175 times that in Ethiopia and 260 times that in Mozambique? Why or why not?

2. The closed economy in the long run. Suppose that an increase in consumer confidence raises consumers' expectations of future income and thus the amount they want to consume today. How does this change affect investment and the interest rate? (Your answer should include both a graph and a written argument.)

3. Money. Suppose that the money demand M^d is given by

$$M^d = PY \cdot (0.25 - i)$$

where PY denotes nominal income and i denotes nominal interest rate. Also, suppose that $PY = \$100$ and the supply of money is $20. Assume equilibrium in financial markets.

   (a) Define **velocity** of money, V.

   (b) Is the above money demand a quantity theory money demand or a liquidity preference theory money demand? Why?

   (c) Write V as a function of i according to the above money demand.

   (d) Calculate the velocity when $i = 5\%$ and when $i = 15\%$. Explain your answer.

4. Money. Define the **money multiplier**.

   (a) The reserve requirement on demand deposits is 0%. Banks hold 4% of demand deposits as excess reserves. The public holds 79 cents in currency for every dollar it holds on demand deposits. The Bank of Canada increases the monetary base in $1 billion. How much does **M1** increase?

   (b) During the Great Depression, the excess reserves ratio rose dramatically. What do you think happened to the money supply and why?

5. Public budget. Following is the budget for the Province of Saskatchewan as posted by the Ministry of Finance. "Operating expenditure" refers to what we have called primary or program expenditure and "servicing the public debt" refers to interest paid on the outstanding debt.

Revenue, Expense and Budget Balance

($ Millions)

	Estimated **2006-07**	Forecast **2007-08**
Revenue	$7,869.3	$8,389.3
Operating Expenditure	7,789.7	7,680.3
Servicing the Public Debt	560.0	541.0
Fiscal Stabilization Fund	555.4	(97.9)
Budget Surplus	**$75.0**	**$70.1**

(a) Calculate the **primary (program) deficit or surplus** for the two fiscal years (estimated or forecasted as the case may be)

(b) Calculate the **(official) deficit or surplus** for the two years.

(c) Explain the discrepancy between your figures and the posted figures.