Week 6 Tutorial Solution
ECON203: Macroeconomics 2
Dr. Lei Pan — Semester 2, 2019
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Multiple Choice Questions

Question 1. The elasticity of output with respect to capital
(a) is the increase in output resulting from an increase in the capital stock.
(b) is the percentage increase in output resulting from a 1% increase in the capital stock.
(c) is always greater than one.
(d) is the inverse of the elasticity of output with respect to labour.

Answer: B

Question 2. Suppose the current level of output is 5000 and the elasticity of output with respect to capital is 0.4. A 10% increase in capital would increase the current level of output to
(a) 5020.
(b) 5050.
(c) 5200.
(d) 5500.

Answer: C

Question 3. Over the past year, productivity grew 2%, capital grew 1%, and labour grew 1%. If the elasticities of output with respect to capital and labour are 0.2 and 0.8, respectively, how much did output grow?
(a) 1%
(b) 2%
(c) 3%
(d) 4%

Answer: C

Question 4. Total factor productivity growth is that part of economic growth due to
(a) capital growth plus labour growth.
(b) capital growth less labour growth.
(c) capital growth times labour growth.
(d) neither capital growth nor labour growth.

Answer: D

Question 5. Labour productivity increased so much in the second half of the 1990s because of
(a) improved information and communications technologies.
(b) higher levels of educational attainment by workers.
(c) cheaper foreign imports used in production.
(d) increased foreign competition.

Answer: A

Question 6. Edward Denison found that labour's contribution to output growth in the United States since 1929 was attributable to all the factors below EXCEPT
(a) rising population.
(b) an increase in the percentage of the population in the labour force.
(c) an increase in the number of hours worked per person.
(d) higher educational levels.

Answer: C

Question 7. All of the following are explanations of the post-1973 productivity slowdown EXCEPT
(a) problems in measuring productivity.
(b) changes in the legal and human environment.
(c) higher oil prices.
(d) greater competition from foreign imports.

Answer: D

Question 8. A new pollution law requires businesses to pay for inspections of their plants by independent pollution-monitoring firms. What effect is this likely to have?
(a) Increase productivity
(b) Increase the capital stock
(c) Reduce productivity
(d) Increase the demand for labour in those firms

Answer: C

Question 9. Why do some people think that the productivity slowdown since 1973 is just a return to normalcy after fast productivity growth during the previous 25 years?
(a) Productivity growth of the previous 25 years was abnormally low.
(b) The Great Depression and World War II had prevented technological opportunities from being exploited.
(c) The United States is the only country to face the slowdown, due to poor regulatory decisions.
(d) The United States has allowed countries like Japan to steal its technological breakthroughs.

Answer: B

Question 10. Greenwood and Yorukoglu view the post-1973 productivity slowdown as resulting from
(a) the information technology revolution.
(b) high oil prices.
(c) measurement errors.
(d) technological depletion.

Answer: A

Problem Solving Questions

Question 11. Classifying Transactions. Classify the following as a transaction reported in a sub-component of the current account or the capital and financial accounts of the two countries involved:

(a) The Spanish orchard deposits half the proceeds in a Eurodollar account in London.

No recording in the U.S. balance of payments, as the transaction was between foreigners using dollars already deposited abroad. A debit to the income receipts/payments of the British current account; a credit to the income receipts/payments of the Spanish current account.

(b) A London-based insurance company buys U.S. corporate bonds for its investment portfolio.

A debit to the portfolio investment section of the British financial accounts; a credit to the portfolio investment section of the U.S. balance of payments.

(c) An American multinational enterprise buys insurance from a London insurance broker.

A debit to the services part of the U.S. current account; a credit to the services part of the British current account.

(d) A London insurance firm pays for losses incurred in the United States because of an international terrorist attack.

A debit to the services part of the British current account; a credit to the services part of the U.S. current account.

(e) Cathay Pacific Airlines buys jet fuel at Los Angeles International Airport so it can fly the return segment of a flight back to Hong Kong. Hong Kong keeps its balance of payments separate from those of the People's Republic of China.

Hence a debit to the goods part of Hong Kong's current account; a credit to the goods part of the U.S. current account.

Question 12. Consider the UK as a small open economy.

Use the goods market clearing condition and the open economy context to describe what happens to the long run trade balance in response to the following events:

(a) A fiscal contraction by the UK government.

Reduce national savings $\rightarrow$ reduces net capital outflow $\rightarrow$ reduces net exports

(b) The introduction of new trade restrictions with the EU following Brexit.

Reduces both exports and imports; net exports unaffected.

(c) Brexit reduces consumer confidence.

Increases national savings $\rightarrow$ increases net capital outflow $\rightarrow$ increases net exports

(d) Tax reforms increase incentives for UK firms to invest in renewable energy.

Shifts investment function outwards; but saving fixed. So the result is a fall in net capital outflow and a reduction in net exports.

(e) A new range of UK made smartphones takes the domestic market by storm.

Increases national savings $\rightarrow$ increases net capital outflow $\rightarrow$ increases net exports

(f) Bank of England doubles the money supply.

Only leads to inflation in the long run classical model.