SECTION B

*Answer **one** question from this section.*

Macroeconomics

3. (a) Explain the income, output and expenditure methods used to measure real gross domestic product (GDP).   *[10 marks]*

    (b) Discuss the usefulness of real GDP per capita as a method of measuring the living standards of a country's population.   *[15 marks]*

4. (a) Using an appropriate diagram, explain why a country might experience a deflationary gap.   *[10 marks]*

    (b) "Fiscal policy is the most effective way of bringing an economy out of recession." To what extent is this statement valid?   *[15 marks]*

SECTION B

*Answer **one** question from this section.*

Macroeconomics

3. (a) Explain the difference between cost-push and demand-pull inflation.   *[10 marks]*

    (b) "A rise in the inflation rate will always result in negative consequences for the economy." To what extent is this statement true?   *[15 marks]*

4. (a) Using an appropriate diagram, explain how a recession might lead to more poverty.   *[10 marks]*

    (b) Evaluate the view that attempts to achieve greater equity in the distribution of income will reduce economic efficiency.   *[15 marks]*

SECTION B

*Answer **one** question from this section.*

Macroeconomics

3. (a) Explain the difficulties involved in measuring the rate of inflation.   *[10 marks]*

    (b) Discuss the view that deflation is a more serious problem than inflation for the economy of a country.   *[15 marks]*

4. (a) Explain how labour market reforms may be used to promote economic growth.   *[10 marks]*

    (b) "Market-oriented supply-side policies will always be more effective in promoting economic growth than demand-side policies." To what extent do you agree with this statement?   *[15 marks]*

SECTION B

*Answer **one** question from this section.*

Macroeconomics

3. (a) Distinguish between the causes of cyclical (demand-deficient) unemployment and structural unemployment.   *[10 marks]*

    (b) Evaluate government policies used to deal with cyclical unemployment.   *[15 marks]*

4. (a) Explain how a producer price index could be useful in predicting future inflation.   *[10 marks]*

    (b) To what extent can supply-side policies help in fighting inflation?   *[15 marks]*

Term 1+2: 79%
IB: 6 (6.6)
Q3: 24   Q4: 24
excellent! 48/50
86%

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Candidate session number: / Numéro de session du candidat : / Número de convocatoria del alumno:

| 0 | 0 | 0 | 0 | 3 | 4 | - | B | 9 | 8 | 1 |

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Jerry Jiang.

At the start of each answer to a question, write the question number in the box. / Avant de répondre à une question, veuillez écrire le numéro de la question que vous allez traiter dans la case prévue à cet effet. / Al comienzo de cada respuesta, escriba el número de pregunta en la casilla.

Example / Exemple / Ejemplo 27 | 2 | 7 |

Example / Exemple / Ejemplo 3 | | 3 |

2014 May. 4.

M14

(a) A deflationary gap occurs when the actual output at equilibrium is lower than the potential output at full employment level.
Recession is when the economy of a country has its real GDP been falling for at least two consecutive quarters in the business cycle.

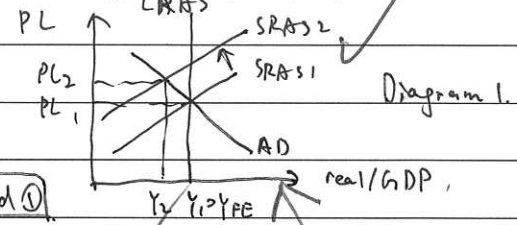It's possible that deflationary gaps are caused by the falling of SRAS. In diagram 1, you can see the case. This might be caused by the increase of point import price from for a factor of production. SRAS1 is shifted in to SRAS2 [Add ①]. Companies are not efficient and doesn't need so many people so that employees are fired and employment might decrease.

Diagram 1.

In diagram 2, you can find another case of deflation from another cause in Japan.

Diagram 2.
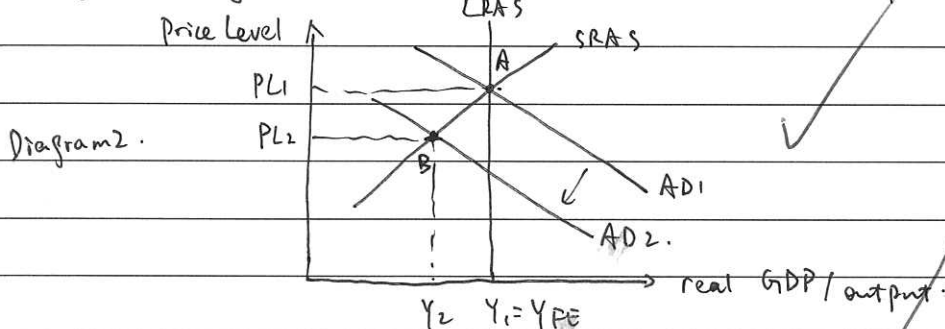
Add ①: Y₁ at full employment level falls to Y₂, creating a deflation gap, while PL rise to PL₂, altogether & creating a stagflation.

- initially, the economy equilibrium is at point A with price level PL1 and Y1 at full employment level.
- Japanese government increase the level of taxation, for instance, they create taxes for every single person leaving the boarder of Japan.
- The AD1 curve shifts to the left, bringing the equilibrium from A to B.
- The Price level drops from PL1 to PL2, the real GDP falls from Y_{FE} to Y2, which is below full employment level, indicating a deflationary gap.

The reason why rising taxation level shifts in AD:
- $C = Y - T - S$. when $T\uparrow$, C, the consumption drops.
- $AD = C + G + I + X - M$. when $C\downarrow$, AD decreases, causing it to shift in.

Above is why the taxation level increase in Japan cause a deflationary gap.

(b)

Please refer to the definition of recession in part (a).

Fiscal policy is a demand side policy carried out by the government through manipulation of its own expenditures and taxation levels, in order to change the level of aggregate demand.

In Diagram 3, you can find how Japan might save themselves through fiscal policy:

Diagram 3
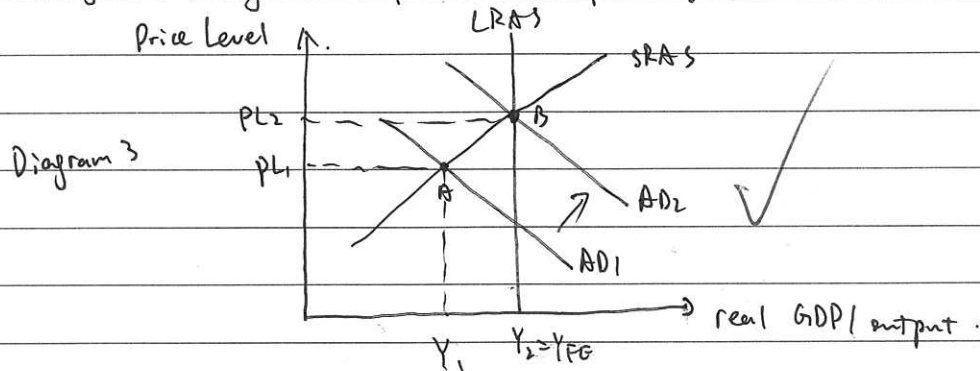
- initially, the equilibrium is at A, with Y1 and PL1. Y1 is below YFE.
- Japanese government implemented a fiscal policy, like building the fantastic underground system or reducing taxes.
- AD1 shifts out to AD2, bring A to B.

· the real GDP rise from Y_1 to $Y_2 = Y_{FE}$, while price level rise from PL_1 to PL_2. The fiscal policy works.

why would the fiscal policy work?

Fiscal policy.

· decrease taxation level.

profit after tax ↑

(1) $T\downarrow$ → return of interest rise? → $I\uparrow$ → $Q/K\uparrow$?

(2) $C = Y - T - S$. $T\downarrow$, $C\uparrow$

$AD = C + G + I + X - M$. $I\uparrow$ and $C\uparrow$ ⟹ $AD\uparrow$.

· government expenditure.

· research and development ex. producing more advanced machinery in stationary manufacture ⟹ $Q/K\uparrow$.

· infrastructure. ex. build underground network. ⟹ $Q/K\uparrow$?

· health care and education: better labour force. $Q/L\uparrow$.

$AD = C + G + I + X - M$. as $G\uparrow$, $AD\uparrow$, so it shifts to the right.

Also, the government expenditure part can boost long run development that might shift LRAS to the right.

(left margin, vertical) confusion between demand side + supply side policies

Evaluations:

① In Japan's recession case, taxation level decrease won't work. During recession, people tend to save money. They fall into a self-fulfilling prophecy of the price might decrease. So they don't spend it. $C = Y - T - S$. the decreased tax will lead to increase in saving instead of decrease in C. Because cons lack confidence, when $T\downarrow$, $S\uparrow$ instead of $C\uparrow$

② Compare to monetary policy which deal with interest rate:

(1) fiscal policy is more direct since it directly influences the AD curve. only through G, T is indirect

(2) fiscal policy takes more time and efforts to respond to recession since there is recognition, policy, and implementation gap and political constraints as well.

(3) fiscal policy require the government to increase expenditure. This

might lead to a monetary debt and develop into a deficit. They need to borrow money to fill in that deficit so crowding-out effect might happen. interest rate increase, so investment are discouraged private businesses and investment are " crowded out".

③ automatic stabilizer:

aggressive income tax and government measures:

{ at peak: G↓, taxation level increase   why?

{ at trough: G↑, taxation level decrease.   why?

G: unemployment benefits

T: progressive income tax
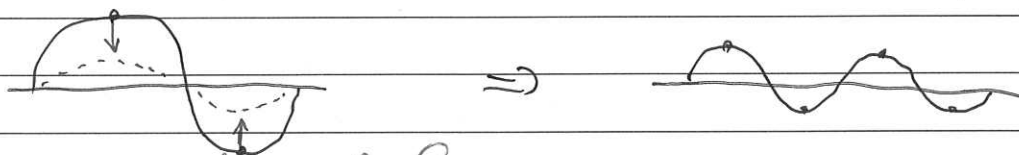
counter-cyclical

This will decrease the "wave" curve in the business cycle by in-time reaction and decrease the level of peak and trough so that a more healthy and stable economy is achieved.

(14) good but some concepts not

fully explained or developed.

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Jerry Jiang

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Example / Exemple / Ejemplo 27 | 2 | 7 |
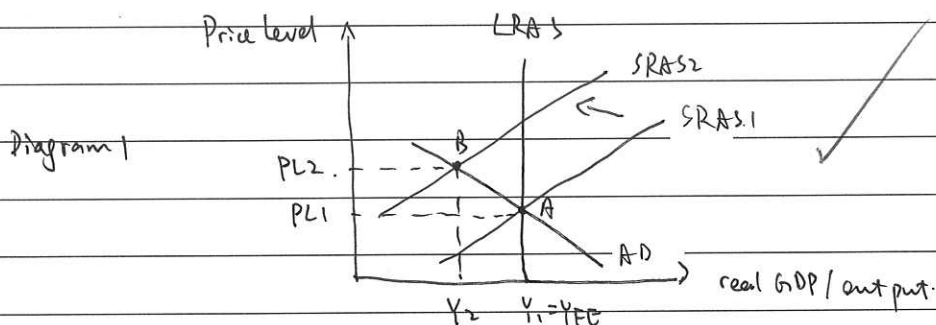
Example / Exemple / Ejemplo 3 | | 3 |

| | 3 |

N14

2014. Nov. Q3.

(a). Inflation is a continuous growth of the general price level.

Cost-push inflation is inflation caused by the falling of SRAS due to increased cost for factor of production.

Demand-pull inflation is inflation caused by AD rising faster than SRAS in an economy.

Diagram 1

In diagram 1, you can find the cost-push inflation in Pakistan.

· initially, the economy equilibrium is at A, with price level at PL1 and real GDP $Y_1 = Y_{FE}$ at full employment level. $\emptyset$ or P?

· However, the import of oil from Kuwait dramatically increase. This increase the cost of factors of production.

· The SRAS1 curve is shift in to SRAS2, moving the new market equilibrium to B.

· now the real GDP/output in Pakistan is at $Y_2 < Y_{FE}$, creating a deflationary gap.

· PL2 now is higher than PL1, price level increase indicating inflation.

· summarizing the two previous points, there's a stagflation going on in Pakistan.

Price Level. ↑ LRAS SRAS

Diagram 2.

PL2.

PL1

B

A

AD1 AD2

→ real GDP/output

$Y_{FE} = Y_1$ Y_2
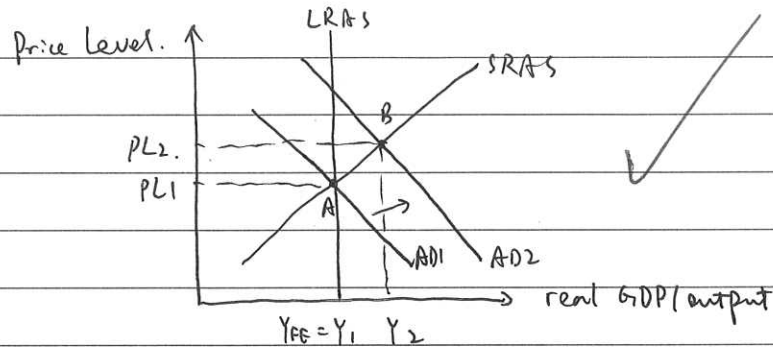
In Diagram 2, you can find the case of demand-pull example in Zimbabwe.

- Initially, the equilibrium is at A with price floor at PL1 and output at $Y_1 = Y_{FE}$, the full employment level.

- Zimbabwe government decided to put government expenditure on health care and education and reduce taxes.

- AD1 curve shifts out to AD2, bringing the equilibrium from A to B.

- the real GDP grows from Y_1 to Y_2, indicating an expansion (growth in output).

- the price level rise from PL1 to PL2 indicating an inflation.

① in cost-push inflation, Pakistan has a stagflation.

business are not producing much and they don't need too many people. Employees will be fired and employment rate decrease.

② in demand-pull inflation, Zimbabwe government increase government spending and decrease tax.

- $C = Y - T - S$. when tax decrease, consumption increase.

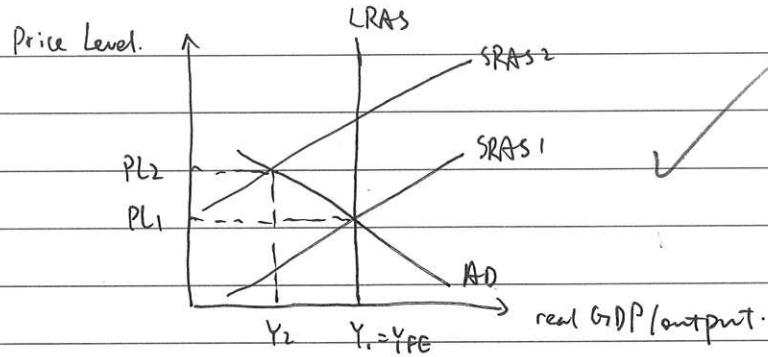- $AD = C + G + I + X - M$. when G and C increase, AD increase.

that's why AD1 curve shifts out to AD2 in Zimbabwe.

(b)

Please refer to the definition of inflation in part (A).

10
good

Diagram 3.

Price Level. (↑) LRAS SRAS2 SRAS1

PL2 - - - - -
PL1 - - - - -

AD

Y2   Y1=YFE   → real GDP /output.

As mentioned in the cost-push inflation section in part (A), Pakistan has a rise of inflation rate due to shifting in of SRAS curve, since their import price of oil from Kuwait increase.

There're terrible consequences for inflation, especially in case like the cost-push stagflation in Pakistan.

① Households with fixed income can be hurt. The numeric value of their wages stays the same while the price level increase. The real wages drops which brings an disadvantage towards the household.

② The business stability falls. Businesses in Pakistan can't figure out whether they will profit or not if they invest in Pakistan. The investment will fall, so the AD will drop. In the long run, employment might fall as well.

③ There will be a redistribute of income in Pakistan. Borrowing money during inflation might benefit the borrowers if the inflation rate is higher than expected. Because when the borrowers pay back a certain numeric value of money, its real value decreases. For poor people, it's not easy for them to borrow money, since they don't have wealth and are not trusted by Pakistan banks. However, rich people will be able to, so that's why there's a redistribution of income.

④ The competitiveness in export market falls because the price level in Pakistan rises, for instance, agriculture product like mango and rice is not wanted in the international market; while products like cars are more preferred from import than domestic produced.

⑤ There's a ineffectiveness in the price mechanism. In normal case, dealers in Pakistan can adjust themselves according to price mechanism as demand and price rise or drops. However during inflation, they don't know the rise of price is caused by the ~~decr~~ increase in demand or inflation. ? So the market will not be so efficient.
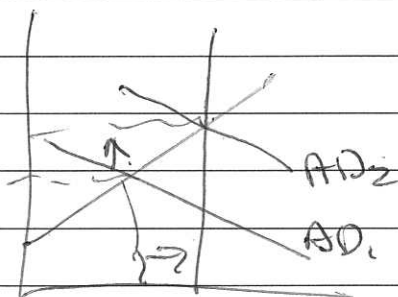
However, there're good consequences brought by inflation:

① as mentioned above, borrowers might benefit from borrowing money if the inflation rate is higher than expected.

② There're labor unions in Pakistan so that wages aren't so easy to fall. However, with inflation, the real wages decrease, which helps to adjust and make companies more competitive.

Inflations are generally bad, especially during stagflation (cost-push). In demand-pull, a bit of inflation is good since it's one of the four economic goals. However, ~~too~~ too much inflation like Zimbabwe is still bad.

⑭ good.

What about AD shifting out

when in a recessionary gap?

There is inflation but Y↑ + Un↓?

rec. gap is
closed +
price's some
inflation.

AD₂

AD₁