SECTION A

1 a. Is it desirable for a country to have a large gross domestic product? Explain. [4 marks]

b. Define the following: (i) Net Investment

(ii) National Income [4 marks]

c. Given the following data:

<table>
<thead>
<tr>
<th>Description</th>
<th>EC$ million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic capital formation</td>
<td>50.7</td>
</tr>
<tr>
<td>Gross domestic product at market prices</td>
<td>1663.4</td>
</tr>
<tr>
<td>Retained business earnings</td>
<td>80.1</td>
</tr>
<tr>
<td>Income payments to foreigners</td>
<td>273.0</td>
</tr>
<tr>
<td>Subsidies</td>
<td>18.6</td>
</tr>
<tr>
<td>Capital Consumption allowance</td>
<td>10.2</td>
</tr>
<tr>
<td>Indirect taxes</td>
<td>290.5</td>
</tr>
<tr>
<td>Income accruing to Public Sector</td>
<td>40.0</td>
</tr>
<tr>
<td>Factor payments from abroad</td>
<td>9.8</td>
</tr>
</tbody>
</table>
Calculate the following:
(i) National Income
(ii) Net Investment
(iii) Personal Income

[10 marks]

d. Assume that gross domestic product is $6000, personal disposable income is $5100, the government deficit is $200, consumption is $3800, and the trade deficit is $100. What is the size of:

(i) Private Saving
(ii) Investment
(iii) Government Spending

[8 marks]
e. Distinguish between a government deficit and a trade deficit.

[4 marks]

2. a. What is the GDP deflator? Identify a major difference between the GDP deflator the consumer price index.

[5 marks]

b. A representative basket of goods cost $215.00 in 2007, $236.50 in 2008 and $268.75 in 2009. Assuming that the base year is 2007, Calculate

(i) The price index for each year

[3 marks] [4 marks]

c. The GNP in current prices, of the country for which prices are represented in Part b above is $14828 million in 2007, $16014 million in 2008 and $18576 million in 2009. Bearing in mind the figures in Part b determine:

(i) the year in which the economy contracted and the rate of contraction
(ii) the year in which the economy expanded and the rate of expansion.

[9 marks]

d. Use the data below to calculate the growth rate of per capita real GDP between 2001 and 2007.

<table>
<thead>
<tr>
<th>Year</th>
<th>Real GDP in $million (2000 prices)</th>
<th>Population in millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>8994</td>
<td>11.7</td>
</tr>
<tr>
<td>2007</td>
<td>9963</td>
<td>12.2</td>
</tr>
</tbody>
</table>

[4 marks]

e. Give two reasons why economists consider per capita real GDP to be an imperfect measure of the standard of living of citizens of a country.

[5 marks]

3. a. Explain the slopes of the following curves:

(i) the demand for loanable funds
(ii) the supply of loanable funds

[6 marks]
b. What is meant by the term ‘crowding out effect’? [3 marks]

c. Suppose government moves from a balanced budget position to a budget deficit. Use the market for loanable funds diagram to explain what happens to:

   (i) Rate of interest [18 marks]
   (ii) Private Spending
   (iii) National Savings

d. Explain how higher saving leads to higher standard of living. [3 marks]

4. a. What is the difference between human capital and technology? [5 marks]

b. Do you think a country can “over invest” in human capital? Explain. [3 marks]

c. Would you rather live in a nation with a high per capita GDP and a low growth rate or in a nation with a low per capita GDP and a high growth rate? [4 marks]

d. International data show a positive correlation between political stability and economic growth.

   (i) Through what mechanism could political stability lead to economic growth. [3 mark]

   (ii) Through what mechanism could strong economic growth lead to political stability. [3 marks]

e. Suppose that Reshaun’s Sound System is considering building a record studio in Jamaica.

   (i) Assume that Reshaun’s Sound system needs to borrow money on the bond market. Why would an increase in interest rates affect the decision about whether to build the studio? [3 mark]

   (ii) If Reshaun’s Sound System has enough of its funds to finance the new studio without borrowing, would an increase in interest rates still affect the decision about whether to build the studio? Explain. [3 marks]

f. You find that your pay cheque for the year is higher this year than last year. Does that mean that your real income has increased? Explain carefully. [6 marks]
5. a. Suppose that the T-account for The National Bank of St. Michael (TNBM) is as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves $100,000</td>
<td>Deposits $500,000</td>
</tr>
<tr>
<td>Loans $400,000</td>
<td></td>
</tr>
</tbody>
</table>

(i) If the Central Bank requires banks to hold 5% of deposits of reserves, how much in excess reserves does TNBM now hold? [4 marks]

(ii) Assume that all other banks hold only the required amount of reserves. If TNBM decides to reduce its reserves to only the required amount, by how much would the economy’s money supply increase? [4 marks]

b. List four social costs of inflation. [2 marks]

c. Explain two of the social costs identified in part (b) above. [5 marks]

c. Suppose that changes in bank regulations expand the availability of credit cards so that people need to hold less cash.

(i) How does this affect the demand for money? [2 marks]

(ii) If the Central Bank does not respond to this event, what will happen to the price level? [5 marks]

(iii) If the Central Bank wants to keep the price level stable, what should it do? [5 marks]

f. Briefly explain the classical dichotomy. [3 marks]

6. a. Explain why:

   (i) the aggregate demand curve is downward sloping. [6 marks]
   (ii) the long-run aggregate supply curve is vertical. [3 marks]
   (iii) the short-run aggregate supply curve is upward sloping. [6 marks]

b. Explain using diagrams the effect on prices and output if:

   (i) Households decide to spend a larger share of their income. [4 marks]
   (ii) Farmers experience excellent growing conditions for a prolonged period. [4 marks]
c. Define:
   (i) the nominal exchange rate [2 marks]
   (ii) the real exchange rate [2 marks]

d. Explain what happens if there is an appreciation of the real exchange rate. [3 marks]

7. a. Assume that bananas from Dominica sell for EC$50,000 per tonne, Chiquita bananas, a US brand sell for US$14,800 per tonne, and the nominal exchange rate is US$0.37 per EC$1.
   (i) Explain how you would make a profit from this situation. What would be your profit tonne of bananas? [5 marks]

b. Explain, using diagrams, what happens to the interest rate, consumption, investment, and aggregate demand if the Central Bank sells government bonds to the public. [10 marks]

c. Explain using diagrams how each of the following developments would affect the supply of money, the demand for money, and the rate of interest:
   (ii) Pessimism about the economy increases the amount of cash people hold. [5 marks]
   (iii) The Central Bank increases commercial banks’ reserve requirements. [5 marks]
   (iv) Households decide to spend more money during Crop Over 2009. [5 marks]