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undergraduate
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CPA

CHARTERED
PROFESSIONAL
ACCOUNTANTS

ECON 102 REVIEW SESSION
SPRING 2015 MIDTERM 1
BY BENJI HUANG



DON'T ASSUME YOU'LL FAIL

HOW TO PASS GATEMAN'S EXAMS:

Assume nothing!

If you have to assume, state your assumptions clearly.

WHEN YOU READ THE QUESTION:

Don't panic. Take a deep breath.

Start by defining the question.

WHEN YOU ARE STUCK:

Move on! The test is long.

Prioritize strengths.

HOW WOULD I KNOW?

I got 100% in his course last year :)

Did I get perfect on every single question? No.

Did I do better than most other people? You bet.

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PART 1 – TERMS (BOLDED WORDS IN THE GBOOK)

Know them ALL. Here are a few to practise:

GDP:

Business cycle:

Inflation:

Fixed investment:

Marginal propensity to save (MPS):

Aggregate expenditure function:

Non-factor payments:

Fallacy of Composition:

Frugal economy:

PART 2 – CHAPTER 19

1) How is Macroeconomics different from Microeconomics? (4pts)

2) Explain GDP in detail. (5pts)

3) An economist jokingly says, “If my neighbor gets laid off, it's a recession. If I get laid off, it's a depression.” Explain what assumptions must be made in order for the economist’s joke to be technically correct. Use the terms frictional, structural, and cyclical unemployment. (6pts)

4) In a land far, far away, a kingdom is moving out of a recession after a period of prolonged deep freeze. As you are the royal advisor, the Queen asks you to give a likely explanation as to why the unemployment rate is still rising even though the employment rate has steadily increased. You know that the change in population has been negligibly over the years. (4pts)

5) Tom is a student in the U.S.. He observed that shops in the local mall was full to the brim with customers during the weekends back in 2007. He remembered that starting 2008, the number of shoppers began to drop visibly. Later in 2009 some of the stores where there used to be long lineups started to cut down the number of cashiers. This wasn't unique to the local mall either. In 2009, no matter where Tom went, he saw the same changes. Then in 2010, gradually, more customers began to shop regularly at those stores again.

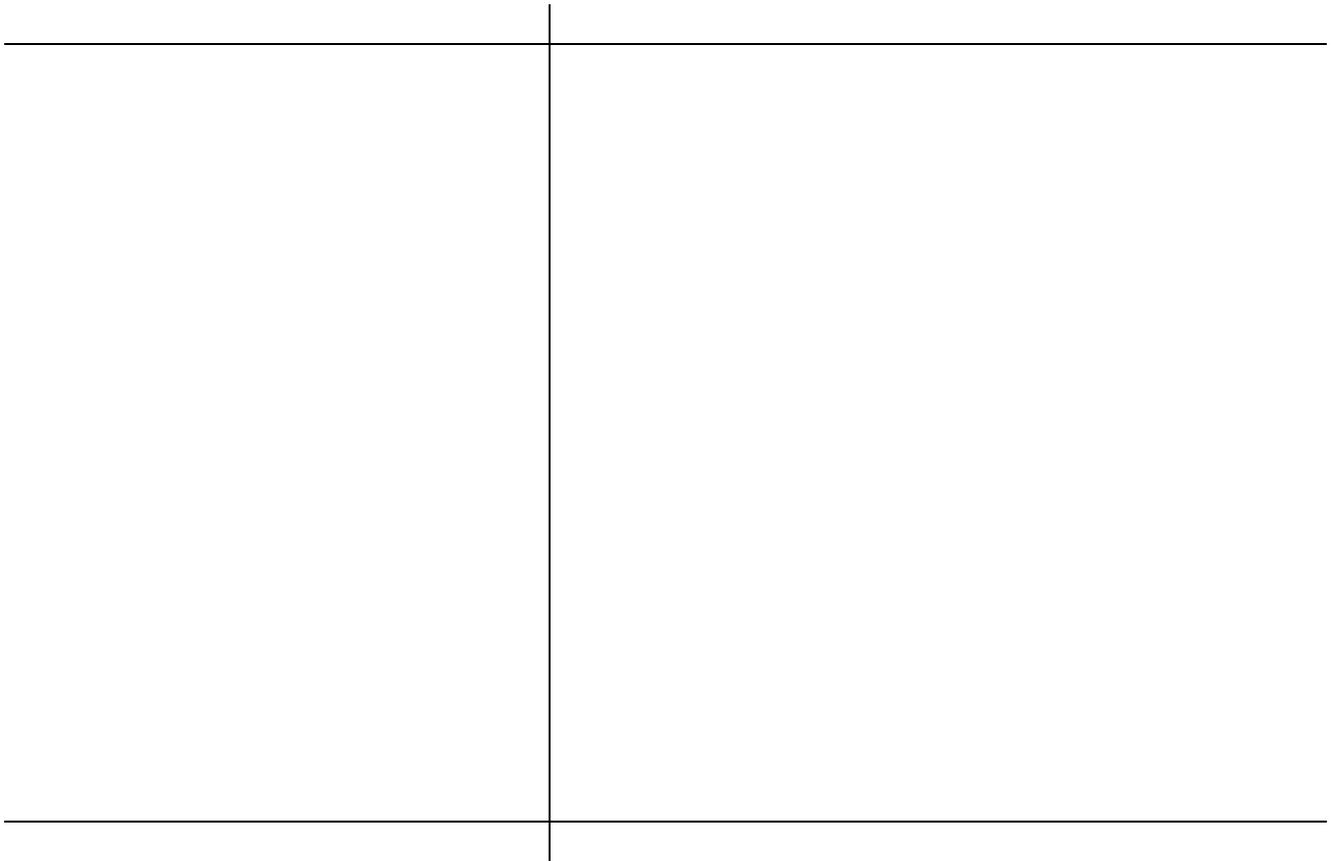
Tom needs help putting his observations into the business cycle framework. (4pts)

Tom would like you to explain what is likely to happen next. (2pts)

PART 3 – CHAPTER 20

1) Sally works at an interior BC mining firm as an operations manager. Her monthly salary is \$14,000. Her firm sells minerals to both local and foreign companies. Last month, Sally bought an xPhone 6 from the local Banana Store for \$8,000 (of which \$1,000 is tax). She knows that most of the parts that make up an xPhone come from Taiwan. Sally puts \$6,000 a month into her bank account. The bank lends money to other Canadian companies to help them finance capital projects. Next month, a new highway will be completed that will shorten her driving distance to work. Explain how the story above fits into the Circular Flow of Expenditure and Income. (10pts)

Draw a diagram to help you along if needed:



2) Is it true that if the real GDP of a country increases, then the nominal GDP must also increase? Explain.* (2pts)

3) Laurence owns a custom skate board manufacturing firm in BC with an annual sales of \$12 million. He tells you, "I am contributing \$12 million every year to the Canadian GDP!" As he was speaking, a truck from a wood supplier arrived at his workshop. You immediately pointed out to Laurence that he made a mistake. What is the mistake? (1pt)

Laurence knows that in order to produce \$12 million worth of skateboards, he incurs a total cost of \$10 million, which leaves him with a \$2 million profit to himself every year. Of the \$10 million in cost, \$5 million are spent on paying craftspeople, \$1 million go to the bank to pay for interests, \$1 million are paid to the gov't in sales tax, and \$1 million are lost to depreciation. A government grant for sustainable business initiative reduces his cost per year by \$1 million. Calculate a more accurate GDP for Laurence's firm using the income approach to accounting. (4pts)

4) Lucy reads a blog: "... Canada is importing \$486 billion worth of goods from foreign countries in 2014. Spending on goods produced in other countries only helps the economy of our trading partners..." Explain to Lucy how imports are accounted for in GDP calculation and why. (2pts)

5) Jake hears that GDP is not a perfect measure of economic activity. Explain to Jake why it is not a perfect measure. (2pts) Tell Jake in what way is GDP a good indicator of living standard despite being an imperfect measure. (2pts)

6) How come we do not count the money you put into the stock market as "investment" when we calculate GDP? (2pts)

PART 4 – CHAPTER 21/22

1) What is on the x-axis and y-axis of an aggregate expenditure function? (1pt) Are they measured in real or nominal terms and why? (2pts)

2) Helen would like to know what will likely happen to the marginal propensity to consume as well as the average propensity to consumer when interest rate decreases dramatically and why. (3pts)

3) John's family spends about the same amount of money (adjusted for inflation) every year irrespective of the economic condition. Mike takes John's family as an example to refute the Keynesian function of consumption. Mike would likely agree with which other well-known model of consumption and why? (2pts) Is Keynes' function completely wrong? (2pts)

4) Jane thinks that desired investment provides the key mechanism for stabilizing actual GDP at the equilibrium level. If what Jane thinks is correct, how does desired investment help to push actual GDP towards the equilibrium in an AE model? Assume the case in which $Y > Y^*$. (4pts)

5) Explain why governments might not wish to reveal the worst possible outcome of an on-going recession to the public. As a matter of fact, governments often project very optimistic outlooks. Why? (5pts)

6) You're a close advisor to Margret who is recently appointed the Minister of Finance in a country suffering from a steep recession. Margret wants to hear your advice on how she can design fiscal policies to bring the economy out of the recession:

Explain to Margret the best she could do assuming she ignores any long term adverse consequences to the government. Explain why your suggested policy would work. (6pts)

After hearing your initial suggestion, Margret shakes her head, "No can do. I don't want to put the government at risk of bankruptcy." Explain the rationale behind Margret's concerns. (4pts)

Understanding Margret's concerns, you suggest a compromise on your initial advice. How would your new advice help bring the country out of a recession without putting the government at risk of bankruptcy? (4pts)

PART 5 – CHAPTER 23

1) Compare demand-determined SRAS curve with the classical SRAS curve. (4pts) Explain how both are valid in the more realistic SRAS model we use today. (2pts)

2) Josh observes a rapid inflation in his native country. He is perplexed by why inflation results in a shift to the AE curve but only a movement along the AD curve. Explain to Josh using terms you learned in Econ 102. (3pts)

3) Alex is a rookie economist. He correctly deduces that the economy's marginal propensity to spend is 20%. He immediately claims that a positive aggregate demand shock in the form of a \$10 billion increase in export will increase real GDP by \$12.5 billion. Explain to Josh why his statement is likely way off mark. Hint: AS curve. (5pts)

4) Discuss how a recession in Europe would affect Canadian GDP and price level in the short run and long run using the AD-AS model.* (2pts)

5) Article excerpt taken from Financial Post, titled “In Canada’s economy there’s Alberta, and there’s everywhere else” by Greg Quinn on July 23, 2014

The oil- and gas-rich western province of Alberta was responsible for all of Canada’s net employment growth over the past 12 months, adding 81,800 jobs while the rest of Canada lost 9,500. Alberta’s trade surplus, \$7.4 billion in May, almost matched the deficit rung up everywhere else.

Alberta’s growing power is doing more than putting energy ahead of manufacturing exports such as Ontario’s cars and Quebec’s aircraft. It’s drawing tens of thousands of young people to the province, seeking energy jobs with some of the country’s highest salaries.

It’s also posing a challenge to policy makers: Oil wealth has led to a stronger Canadian dollar, squeezing Ontario and Quebec manufacturers. Canada’s central bank is keeping interest rates near historic lows, looking for a weaker currency to boost exports.

“We see a two-track economy,” Bank of Canada Governor Stephen Poloz said at a July 16 press conference after his decision to extend the longest interest-rate pause since the 1950s. Canada’s non-energy exports have disappointed, he said, holding back growth. At the same time, “energy exports have indeed been quite strong and we expect that to be a continuing trend.”

Alberta’s labor market has gone “from a very tight unemployment rate to an extremely acute, critical point,” Luft said by telephone. “They are really sitting at zero unemployment.”

What are some interesting implications of a “two-tracked economy” for Canada’s national GDP? How does a “two-tracked economy” affect the way we interpret national GDP? (2pts)

How might a sustained drop in oil prices affect Alberta and Ontario differently? What about Canada as a whole? (3pts)

DISCLAIMERS:

The above questions are only meant to help you solidify your Econ 102 understanding and to help you get a feel for the level of difficulty that you might be reasonably expected to encounter on an actual Gateman exam. However the real exam might take any format and might include: T/F, multiple choice, short answers, calculations, problems, articles, etc.

Most of the questions above are designed by the author based on his past experience with Gateman's exams, with the notable exception of starred (*) questions which are taken with permission from professor Alfred Kong's Econ 102 sample exam. Starred questions are included by the author based on the judgement that they are reasonably similar to the types of question that Gateman has asked before.

As always, knowledge comes first. Exam-taking finesse comes second.