

C 0.65.

D 0.70.

68. On the portion of a worker's labour supply curve that is backward-bending,

A the income effect is negative.

B the substitution effect is negative.

C the substitution effect outweighs the income effect.

D the income effect outweighs the substitution effect.

69. Suppose the exchange rates between the United and Canada are in long-run equilibrium as defined by the idea of purchasing power parity. If the law of one price holds perfectly, then differences between U.S. and Canadian rates of inflation would:

A have no effect on nominal exchange rates.

B be completely offset by changes in the real exchange rate.

C be completely offset by changes in the nominal exchange rate.

D lead to a change in the real purchasing power of each country's currency when it is converted to the other country's currency.

70. Every financial market has which of the following characteristics?

A It determines the level of interest rates.

B It allows common stock to be traded.

C It allows loans to be made.

D It channels funds from lenders-savers to borrowers-spenders.

Use the following information to answer Questions 18 and 19:

Suppose that Dan's utility function is given by $U(I) = 10\sqrt{I}$, where I represents annual income. He is offered a chance to take a job that offers a 0.7 probability of earning \$85,000 and a 0.3 probability of earning \$34,000.

71. The standard deviation of the job's income is:

A \$23,371.14.

B \$23,029.39.

C \$24,494.90.

D \$24,745.91.

72. If Dan were to take the job, how much insurance premium would he be willing to pay to protect against the variable income associated with the job?

A \$2,356.17.

B \$2,411.34.

C \$2,584.71.

D \$2,718.98.

73. In which of the following situations would you prefer to be the borrower?

A The interest rate is 9 percent and the expected inflation rate is 7 percent.

B The interest rate is 4 percent and the expected inflation rate is 1 percent.

- C The interest rate is 13 percent and the expected Inflation rate is 15 percent.
- D The interest rate is 25 percent and the expected inflation rate is 39 percent.

74. Overnight funds are:

- A loans made by the Bank of Canada to banks.
- B loans made by the banks to the Bank of Canada.
- C loans made by banks to each other.
- D funds raised by the federal government in the bond market.

75. With fixed exchange standard, if the domestic demand for foreign exchange increases:

- A inflation will increase.
- B the domestic currency must be depreciated.
- C the central monetary authority must meet the demand out of its reserves.
- D central monetary authority must increase the supply of domestic money.

76. The "lemons problem" is a term used to describe the:

- A moral hazard problem.
- B adverse selection problem.
- C free-rider problem.
- D diversification problem.

77. The tendency for individuals to assign higher values to goods when they own the goods than when they do not possess the goods is known as the

- A income effect.
- B anchoring effect.
- C substitution effect.
- D endowment effect.

78. If the firm hires to a point where the marginal expense of labour is greater than the marginal revenue product of labour, then

- A profits could be increased by increasing employment.
- B profits could be increased by reducing employment.
- C profits are maximized.
- D total cost must be greater than total revenue.

79. The retail price of a loaf of bread was \$2,89 in 2005 and \$4,49 in 2015. When 2010 is the base year the CPI value is 84.7 for 2005 and 116.9 for 2015. What is the percentage change in real price of bread from 2005 to 2015?

- A 12.57%
- B 15.89%
- C 21.74%
- D 24.36%

80. If fluctuations in interest rates become smaller, then, other things equal, the demand for stocks _____ and the demand for long-term bonds _____.

- A decreases; decreases
- B decreases; increases
- C increases; increases
- D increases; decreases

81. All of the following are differences in capital flows today from the past, except:

- A the increasing variety of financial instruments.
- B the reduction in transaction costs for foreign investment.
- C the need to protect from sudden changes in currency values.
- D the problem of volatility in financial capital flows.

82. If the possibility of a default increases because corporations begin to suffer losses, then the default risk on corporate bonds will _____, and the bonds' returns will become _____ uncertain, meaning that the expected return on these bonds will _____, everything else held constant.

- A increases; more; decreases
- B increases; less; decreases
- C decreases; more; increases
- D decreases; less; increases

83. Along any downward sloping straight-line demand curve:

- A both the price elasticity and slope vary.
- B the price elasticity varies, but the slope is constant.
- C the slope varies, but the price elasticity is constant.
- D both the price elasticity and slope are constant.

Long Answer Questions

– Answer all questions in INK in the space provided. If you need more space, write on the blank pages on the left-hand side, but indicate this clearly.

1. The demand and supply of unskilled labour are estimated by the following equations:

$$\text{Demand: } L_D = 4,950 - 225W$$

$$\text{Supply: } L_S = -1,175 + 400W$$

where W is hourly wage rate and L is millions of labour hours.

(a) Calculate the equilibrium wage and quantity of labour. (2 marks)

(b) If the government introduces a minimum wage of \$11.80, calculate the deadweight loss. (3 marks)

(c) Plot the demand and supply curves indicating the values for the x- and y-intercepts. Illustrate the equilibrium wage and quantity of labour, and the deadweight loss. (3 marks)

(d) Calculate the arc wage elasticity of demand for labour between the equilibrium and the minimum wages. (2 marks)

2. A firm's production function is $Q = 2K^{0.5}L^{0.9}$, where Q is units of output, K is CAPITAL, and L is labour. The cost of capital is \$80 per hour and the cost of labour is \$30 per hour.

- i. Find the marginal rate of technical substitution. (3 marks)
- ii. Find the optimum quantities of K and L required to produce 2,400 units of output (4 marks)
- iii. The firm wants to increase output to 3,200 units. Find the optimum input mix to produce quantity. Calculate the scale effect in the employment of labour. (3 marks)

3 Assume interest rate on USD is 8.25% per annum while interest rate on pound sterling is 12.5% per annum. Spot rate of USD/ pound is \$1.74 and the one-year forward rate of USD/pound is \$1.68

- i. Is there an opportunity of covered interest arbitrage? Support your answer with detailed calculation (2 marks)
- ii. Describe your arbitrage strategy based on a USD 1 million transaction. (2 marks)
- iii. What would be the arbitrage profit to be made? Support your answer with detailed calculation (4 marks)

4. Country A and Country B each have 1,000 units of resource. In Country A one unit of resources can produce 9 litres of wine or 5 kilograms of cheese, while in Country B one unit of resources can produce 9 litres of wine or 6 Kilograms of cheese. Suppose that Country A wishes to consume at least 3,000 kilograms of cheese and 3,600 litres of wine while Country B wishes to consume at least 2,700 kilograms of cheese and 4,950 litres of wine.

(a) In separate diagrams plot the production possibilities curves (PPCs) for both countries indicating the values for the x- and y-intercepts, and illustrate their consumption bundles on the PPCs. Plot litres of wine (Q_w) on the x-axis and kilograms of cheese (Q_c) on the y-axis. (3 marks)

(b) Which country has a comparative advantage in wine? In cheese? Explain. (4 marks)

(c) Suppose both countries follow its comparative advantage in deciding where to produce on its PPC. Suggest terms of trade which would satisfy both countries, and illustrate the new combinations of commodities in your diagrams for part (a). (5 marks).

5. Franc has 16 hours in his day from which he can choose to work or relax. When wages are \$10 he chooses to work for 6 hours per day. Recently he won a lottery and they promise him that they will give him \$10 per day for a year, this results Franc only work 5 hours per day now. After the year, Franc is given a raise of \$5 per hour, which results in him working 10 hours per day. Franc claims he is just as happy with his raise as he was when he was working for 5 hours per day.

- a) Determine and plot Franc's **budget constraint** before he won the lottery, and point out where he is maximizing utility.
- b) Calculate the **income effect** from the \$10 non-labor income.
- c) Calculate the **substitution effect** from Franc's wage increase
- d) If Franc's utility curve was steep, what can we infer about the value he places on leisure?