

**Paper 4E13 MACROECONOMICS 2004**

1. (a) What are the main components of national income?  
[10%]

**Consumption (C)**

**Investment (I)**

**Government (G)**

**Exports (X) minus Imports (M)**

**Better candidates will expand on the definitions and discuss issues of measurement.**

(b) What factors determine the aggregate level of investment in the macroeconomy.

[50%]

**Candidates should discuss the following:**

- **Loanable funds theory**
- **Basic Accelerator model**

**Better candidates may discuss:**

- **Limitations of the Accelerator model**
- **Profitability**
- **Business Confidence**
- **Technological Change**

(c) Evaluate the impact of the following on the level of consumption in the macroeconomy:

(i) an increase in income tax [20%]

**Candidates should compare and contrast the Keynesian consumption function with normal income consumption functions. The former suggests that aggregate consumption will fall whereas the latter suggests that there will be little or no impact. Better candidates may discuss the implications for the use of fiscal policy as an active component of demand management.**

(ii) a reduction in the retirement age [20%]

**The life- cycle hypothesis suggests that aggregate consumption will fall as those in work will save more to maintain consumption during their retirement.**

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2. (a) Explain the concept of comparative advantage. [40%]

**Candidate should outline the basic model of comparative advantage , illustrating the benefits in terms of specialisation and allocative efficiency. Better candidates may note the limitations of comparative advantage.**

(b) Evaluate the impact of the following on a country's trade balance:

- (i) an overvalued exchange rate  
[30%]

**Candidates should discuss the impact on exports and imports – the normal result would be deterioration in the trade balance. Better candidates will discuss the importance of:**

- The pricing strategies of firms
- The price elasticity of demand
- Supply elasticities

- (ii) a slowdown in world economic growth [15%]

**A slowdown in world economic growth will, ceteris paribus reduce exports and led to deterioration in the trade balance. Candidates could discuss variations in income elasticities.**

- (iii) the adoption of tariffs by trading partners  
[15%]

**This will lead to a fall in world trade and deterioration in exports and the trade balance. Candidates may discuss the possibility of retaliation to reduce imports.**

3.(a) What are the main factors that cause business cycles?

[30%]

**Candidates can discuss the following:**

- the multiplier/accelerator theory
- the trade cycle
- economic mismanagement
- political business cycles

- (b) In what ways can economic policy be used to reduce the amplitude of business cycles?  
[20%]

**Candidates should discuss the use of demand management to regulate the business cycle. Better candidates will discuss the case that economic policy should not be used as it may increase the volatility of business cycles.**

- (c) What are the main determinants of long-run economic growth?  
[30%]

**Candidates should discuss the key elements of neoclassical exogenous and endogenous growth theories and especially the role of technology.**

- (d) In what ways can economic policy be used to increase the long-run economic growth?  
[20%]

**Candidates will discuss the policy implications of exogenous and endogenous growth theories focussing on the role of capital accumulation in the former and the role of technology and innovation in the latter.**

- 4.(a) Discuss the economic arguments for European Monetary Union (EMU).  
[35%]

**Candidates should discuss the following:**

- **Reduced cost of trade**
- **Improves price transparency**
- **Lower and stable inflation**
- **Lower 'sacrifice ratio'**

- (b) Discuss the economic arguments against European Monetary Union (EMU).  
[35%]

**Candidates should discuss the following:**

- **Loss of policy flexibility**
- **Single interest rate straightjacket**
- **Creation of a multiple-speed Europe**
- **Lack of credibility of the European Central Bank**

(c) Evaluate the possible impact on the UK economy of joining EMU.  
[30%]

**There are a number of possible responses, one would be to evaluate the 5 tests for joining EMU:**

- **evidence of sustainable convergence between Britain and the economies of a single currency**
- **whether there is sufficient flexibility to cope with economic change**
- **effect on investment**
- **impact on the financial services industry**
- **impact on employment**