

RAMAKRISHNA MISSION VIDYAMANDIRA

(Residential Autonomous College affiliated to University of Calcutta)

B.A./B.Sc. FOURTH SEMESTER EXAMINATION, MAY 2023

SECOND YEAR [BATCH 2021-24]

ECONOMICS [HONOURS]

Date : 25/05/2023

Time : 11 am – 1 pm

Paper : CC9

Full Marks : 50

[Use a separate Answer Book for each Group]

Group - A

Answer **any two** questions:

[2×5]

1. a) Discuss, in brief, “The Trilemma/Impossible Trinity of International Finance”.
b) Imagine a decentralized government where the Central bank determines the exchange rate, the Treasury determines fiscal policy, and the two bodies do not coordinate policy effectively. What is the “Assignment Problem” here? How can this be resolved? (2+3)
2. Calculate the euro rates of return on the following assets:
 - a) A painting whose price rises from €200,000 to €250,000 in a year.
 - b) A diamond whose price rises from €20 000 to €21 000 between 2014 and 2015.
 - c) A £10,000 deposit in a London bank in a year when the interest rate on pounds is 2 percent and the €/£ exchange rate moves from €1.36 per pound to €1.17 per pound.
3. Explain how each of the following transactions generates two entries—a credit and a debit—in the Indian balance of payments accounts, and describe how each entry would be classified:
 - a) Mr. Shah of Stockwala.com, Delhi buys a share of a Thai stock company, paying the seller with a check on SBI.
 - b) A student of North Bengal University, Arnab buys a meal at an expensive restaurant in Dhaka, paying with a traveller’s check.
4. State and mathematically prove the Marshall-Lerner condition. What is its relevance with the so-called J-curve phenomenon?
5. Other things equal, how would you expect the following shifts to affect a country's real exchange rate against foreign currencies?
 - a) The overall level of spending doesn't change, but domestic residents decide to spend more of their income on nontraded products and less on tradables.
 - b) Foreign residents shift their demand away from their own goods and toward the home country's exports.

Answer **any one** question:

[1×15]

6. a) According to the theory of purchasing-power parity, the nominal exchange rate equals the ratio of the foreign price level (measured in units of the foreign currency) to the domestic price level (measured in units of the domestic currency). Consider the following data:

Country	Price/Kilo Wheat	Predicted Exchange Rate	Actual Exchange Rate
Indonesia	30,500 rupiah	6,187 rupiah/\$	13,947 rupiah/\$
Hungary	900 forints	?	293 forints/\$
Czech Republic	75 korunas	?	25.1 korunas/\$
Brazil	13.5 real	?	4.02 real/\$
Canada	5.84 C\$	?	1.41 C\$/\$

- i. For each country except Indonesia, compute the predicted exchange rate of the local currency per U.S. dollar when the U.S. price is \$4.93/kilo of wheat.
 - ii. According to purchasing-power parity, what is the predicted exchange rate between the Hungarian forint and the Canadian dollar? What is the actual exchange rate?
 - iii. How well does the theory of purchasing-power parity explain exchange rates? Explain.
- b) Assume linear consumption and import functions, exogenous investment and government expenditure.
- i. Solve the equilibrium expressions for Y and Y^* in the two-country Keynesian Model.
 - ii. Also, derive the expression of the multiplier for a domestic expansion in this 2-country model. Interpret the Repercussion Effect using the expression of the multiplier. (8+7)
7. A small open economy with perfect capital mobility is described by the following equations:

$$C = 50 + 0.75(Y - T)$$

$$I = 200 - 20r$$

$$NX = 200 - 50\varepsilon$$

$$M/P = Y - 40r$$

$$G = 200$$

$$T = 200$$

$$M = 3,000$$

$$P = 3$$

$$r^* = 5.$$

[If e is the nominal exchange rate, then the real exchange rate ε equals eP/P^* , where P is the domestic price level and P^* is the foreign price level. The Mundell–Fleming model assumes that the price levels at home and abroad are fixed, so the real exchange rate is proportional to the nominal exchange rate.]

- a) Derive and graph the IS^* and LM^* curves where income and nominal exchange rate are measured along the horizontal and vertical axes respectively.
- b) Calculate the equilibrium nominal exchange rate, income, and net exports.
- c) Assume a floating exchange rate. Calculate what happens to the nominal exchange rate, income, net exports, and the money supply if the government increases its spending by 50. Use a graph to show your findings.
- d) Now assume a fixed exchange rate. Calculate what happens to the nominal exchange rate, income, net exports, and the money supply if the government increases its spending by 50. Use a graph to show your findings. (3+4+4+4)

Group - B

Answer **any three** questions:

[3×5]

8. "The classical labour market model has the virtue of simplicity but has a significant drawback."— Explain.
9. Explain why interest inelastic investment function can negate the Keynes' effect.
10. Considering the utility function of a particular individual at a particular period t as $u_t = \ln c_t + b \ln(1 - l_t)$, $b > 0$, show how the individual changes the labour supply decision with change in real wages.
11. Define efficiency wage. Why does it predict that the real wage will remain rigid if there is an excess supply of labour?
12. Explain the idea of recession as a coordination-failure.
13. Define real shock and nominal shock. Give an example of each. What type of real shock do Real Business Cycle economists consider the most important source of cyclical fluctuations?

Answer **any one** question:

[1×10]

14. What is the Solow residual and how does it behave over the business cycle? What factors cause the Solow residual to change?
15. Explain, in brief, the implicit contract theory, stating its policy implications.