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BBA in TM, 4th Sem. May 5, 2023

ISLAMIC UNIVERSITY OF TECHNOLOGY (IUT)
ORGANISATION OF ISLAMIC COOPERATION (OIC)

Department of Business and Technology Management

Final Examination
Course No. : BTM 4403
Course Title : Macro Economics

Summer Semester, A. Y.2021-22
Time : 3 Hours
Full Marks : 150

Answer **all 6 (six)** questions. All questions carry equal marks. Marks of each question and corresponding CO and PO are written in the right margin with brackets.

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1. a) Why are the benefits of reducing inflation permanent and the costs temporary? Why are the costs of increasing inflation permanent and the benefits temporary? **5** CO3 PO2

b) The problem of time inconsistency applies to fiscal policy as well as to monetary policy. Suppose the government announced a reduction in taxes on income from capital investments, like new factories. **20** CO3 PO2

i. If investors believed that capital taxes would remain low, how would the government's action affect the level of investment?
ii. After investors have responded to the announced tax reduction, does the government have an incentive to renege on its policy? Explain.
iii. Given your answer to part (ii), would investors believe the government's announcement? What can the government do to increase the credibility of announced policy changes?
iv. Explain why this situation is similar to the time-inconsistency problem faced by monetary policymakers.

2. a) What is the fundamental trade-off that society faces if it chooses to save more? How might the government increase national saving? **5** CO1 PO1

b) Purchasing-power parity holds between the nations of Ectenia and Wiknam, where the only commodity is Spam. **20** CO2 PO2

i. In 2015, a can of Spam costs 4 dollars in Ectenia and 24 pesos in Wiknam. What is the exchange rate between Ectenian dollars and Wiknamian pesos?
ii. Over the next 20 years, inflation is expected to be 3.5 percent per year in Ectenia and 7 percent per year in Wiknam. If this inflation comes to pass, what will the price of Spam and the exchange rate be in 2035?
iii. Which of these two nations will likely have a higher nominal interest rate? Why?
iv. A friend of yours suggests a get-rich-quick scheme: Borrow from the nation with the lower nominal interest rate, invest in the nation with the higher nominal interest rate, and profit from the interest-rate differential. Do you see any potential problems with this idea? Explain.

3.	**a)**	Explain how reducing a government budget deficit makes future generations better off. What fiscal policy might improve the lives of future generations more than reducing a government budget deficit?	**5**	CO3 PO2
	b)	Explain how each of the following policies redistributes income across generations. Is the redistribution from 'young to old' or from 'old to young'? i. an increase in the budget deficit ii. more generous subsidies for education loans iii. greater investments in highways and bridges iv. an increase in Social Security benefits	**20**	CO3 PO2
4.	**a)**	Explain how an increase in the price level affects the real value of money.	**5**	CO2 PO2
	b)	Suppose that people expect inflation to equal 3 percent, but in fact, prices rise by 5 percent. Describe how this unexpectedly high inflation rate would help or hurt the following: i. the government ii. A homeowner with a fixed-rate mortgage iii. A union worker in the second year of a labor contract iv. A college that has invested some of its endowment in government bonds	**20**	CO2 PO2
5.	**a)**	Draw the long-run trade-off between inflation and unemployment. Explain how the short-run and long-run trade-offs are related.	**5**	CO1 PO1
	b)	Illustrate the effects of the following developments on both the short-run and long-run Phillips curves. Give the economic reasoning underlying your answers. i. A rise in the natural rate of unemployment ii. A decline in the price of imported oil iii. A rise in government spending iv. A decline in expected inflation.	**20**	CO1 PO1
6.	**a)**	What adverse effect might be caused by tax incentives to increase saving?	**5**	CO1 PO1
	b)	The problem of time inconsistency applies to fiscal policy as well as to monetary policy. Suppose the government announced a reduction in taxes on income from capital investments, like new factories. i. If investors believed that capital taxes would remain low, how would the government's action affect the level of investment? ii. After investors have responded to the announced tax reduction, does the government have an incentive to renege on its policy? Explain. iii. Given your answer to part (ii), would investors believe the government's announcement? What can the government do to increase the credibility of announced policy changes? iv. Explain why this situation is like the time-inconsistency problem faced by monetary policymakers.	**20**	CO2 PO2