

Suggested Solutions to Assignment 6 (Optional)

Total Marks: 70

Part A True/ False/ Uncertain Questions 70 Marks

Explain why the following statements are True, False, or Uncertain according to economic principles. Use diagrams and / or numerical examples where appropriate. Unsupported answers will receive no marks. It is the explanation that is important.

Each question is worth 10 marks.

A1.

Under the Bretton Woods System, an individual country (other than the United States) with underemployment and excessive current account deficit could achieve both internal balance and external balance only by implementing expansionary fiscal policy. [Diagrams required]

False

See pages (518-522), Figure 18-1 and Figure 18-2 of Krugman's textbook (8th ed.) for an explanation.

or,

See pages (502-506), Figure 18-1 and Figure 18-2 of Krugman's textbook (7th ed.) for an explanation.

A2.

Under a fixed exchange rate system, Home economy is forced to import Foreign inflation. [Diagrams required]

Uncertain

See pages (526-527) and Figure 18-4 of Krugman's textbook (8th ed.) for an explanation.

or,

See pages (510-511) and Figure 18-4 of Krugman's textbook (7th ed.) for an explanation.

A3.

In a two-large-country world with flexible exchange rates, a permanent monetary expansion by Home increases output of both Home and Foreign in the short run.

Uncertain

See pages (544-545) of Krugman's textbook (8th ed.) for an explanation.

or,

See pages (528-529) of Krugman's textbook (7th ed.) for an explanation.

A4.

Home output falls more under a floating rate than under a fixed rate in response to an adverse temporary export demand shock. [Diagrams required]

False

See pages (535-537) and Figure 19-1 of Krugman's textbook (8th ed.) for an explanation.

or,

See pages (519-521) and Figure 19-1 of Krugman's textbook (7th ed.) for an explanation.

A5.

An economy is more vulnerable to the instability in the domestic money market under a fixed rate than under a floating rate. [Diagrams required]

False

See pages (538-539) and Figure 19-2 of Krugman's textbook (8th ed.) for an explanation.

or,

See pages (522-523) and Figure 19-2 of Krugman's textbook (7th ed.) for an explanation.

A6.

In a two-large-country world, governments can achieve macroeconomic outcomes that are better for both countries if they choose macroeconomic policies cooperatively.

True

See Appendix to Chapter 19 (pages 562-564), Figure 19A-1 and Figure 19A-2 of Krugman's textbook (8th ed.) for an explanation.

or,

See Appendix to Chapter 19 (pages 545-547), Figure 19A-1 and Figure 19A-2 of Krugman's textbook (7th ed.) for an explanation.

A7.

In an open economy IS-LM model, a permanent increase in domestic money supply causes a rise in domestic equilibrium interest rate and output, and results into a depreciation of domestic currency.

Uncertain

See Appendix I to Chapter 16 and Figure 16AI-2 of the textbook (6th edition).

Note: I have distributed the copies of this appendix in class. If you do not have a copy of it, please collect it from me during my office hours.