Public Finances in the Economic and Monetary Union (PFEMU)
ISEG - School of Economics and Management

Exam, 30 January 2017 - **Duration: 2h**

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1. **The exam has two groups. The points for each question are mentioned alongside.**
2. **ALL the questions in group ONE need to be answered.**
3. **Choose ONLY 2 questions from group TWO.**
4. **Only non-graphical calculators are allowed. It is not possible to use any reading material. During the exam no clarifications can be made. It is not allowed the use of mobile phones or computers. Improper use will lead to cancellation of the exam.**

I

1. Clarify the main differences bewteen the so-called "weak form" and "strong form" of the Fiscal Thery of the Price Level. [3.00]

2. In the unpleasant monetarist arithmetic framework, consider the per capita government budget constraint

$$\frac{B_t}{N_t} = \left(\frac{1+R_{t-1}}{1+n}\right)\frac{B_{t-1}}{N_{t-1}} + \frac{D_t}{N_t} - \frac{H_t - H_{t-1}}{N_t P_t}$$

where the notation and the variables are the ones used in class. Assuming a constant growth rate, θ, for the monetary base, and its proportionality to prices, $P_t = (1/h)(H_t / N_t)$, determine and show how the growth rate of monetary base impacts on the per capita government debt stock. [3.00]

3. Present the concept on non-keynesian fiscal effects, both theoretically and regarding the strategy to test the hypothesis in practice. [3.00]

4. Consider the following data for the Stability Program of country AA:

Country AA	**2017**	**2018**	**2019**	**2020**
Nominal GDP (EUR billions)	665000	668000	672000	688800
Long-term interest rate (%)	1.5	1.4	1.3	1.3
Primary spending (EUR billions)	372000	373000	373700	374000
Total revenue (EUR billions)	375000	376100	377200	385000
Government debt (EUR billions)	440000	435000	430000	402500
Total spending (EUR billions)	378650	378920	379100	379325

a) Compute for the years 2018, 2019, 2020 the interest rate-growth rate difference and comment on the implications for the intertemporal government budget constraint. [1.50]

b) How does country AA compare in 2020 with a potential implicit rule of thumb of a 0.5 pp response of the budget balance to a 1 pp projected change in growth? [1.50]

II

Answer ONLY 2 of the following 3 questions:

5. Explain succinctly:

a) The characteristics of the so-called preventive and corrective arms of the Stability and Growth Pact. [2.00]

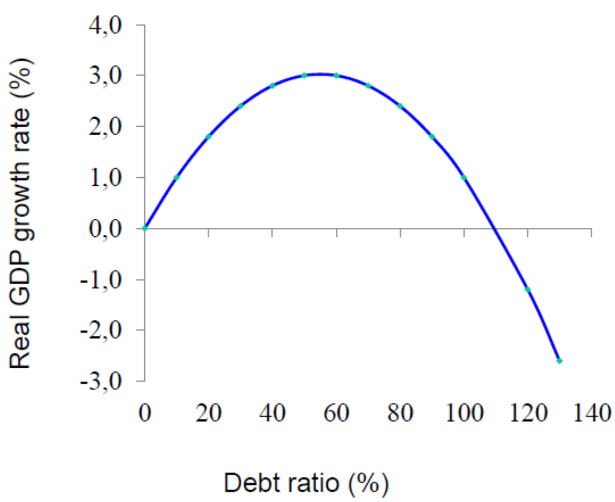
b) The classification of fiscal impulse measures on the economy. How can the size of the individual components be quantified? [2.00]

6. Present the following concepts:

a) The concept of the sustainability of public finances, notably in terms of theoretical underpinnings and of the empirical assessment. [2.00]

b) Explicit and implicit liabilities, contingent and non-contingent liabilities. [2.00]

7. Motivated by the following illustration:



a) Explain the possible links between fiscal policies and economic growth. [2.00]

b) Provide theoretical and graphical analogies to the level of tax revenues. [2.00]