DEPARTMENT OF HUMANITIES & SOCIAL SCIENCES

HUL 213 (Macro Economics)

Major Test (I Sem.,2006-2007)

Date: 27.11.2006   Max.Marks: 40

Time: 10.30 am to 12.30 pm

SECTION – A

Multiple-choice questions (10 marks)

1. Cyclical unemployment refers to
    (a)   a year-to-year fluctuations of unemployment around its natural rate
    (b)   the experience with unemployment of a typical worker over his or her life cycle.
    (c)   long-term trends in unemployment
    (d)   a and b

2. Suppose that, in the simple Keynesian system (with no government and no international trade), national product is less than its equilibrium. Then, according to the basic Keynesian theory
    (a)   prices will fall
    (b)   prices will raise
    (c)   actual investment is greater than desired investment
    (d)   actual investment is less than desired investment

3. In a two country model of trade where imports in both countries are a function of their domestic levels of income, a tax cut in country A
    (a)   Will cause the tax cut in country B
    (b)   Will cause the income level in country B to fall
    (c)   Will have no effect on the income level in country B
    (d)   Will cause the income level in country B to rise

4. If the consumption schedule shifts upward and the shift was not caused by the tax change, the saving schedule
    (a)   will also shift upward
    (b)   will shift downward
    (c)   may shift either upward or downward
    (d)   will not shift

5. In a period of very high rate of inflation, which amongst the following would you generally expect to be the best store of value?
    (a)   cash
    (b)   Bonds
    (c)   Time deposits in bank
    (d)   Gold

6. If there is increase in the price level, the IS curve
    (a)   will shift to the left
    (b)   will shift to he right
    (c)   remain unchanged
    (d)   may shift to the right or to the left, depending on the magnitude of the price change

7. Given the IS equation $Y = kA - k\pi i$, the IS slope increases (the IS curve becomes steeper) when
   (a) k decreases and π decreases
   (b) k increases and π increases
   (c) k decreases and π increases
   (d) k increases and π decreases

8. A bank uses Rs. 1000 of reserves to make a new loans when the reserves ratio is 20 percent
   (a) the money supply initially increases by Rs. 1000
   (b) the money supply initially increases by Rs. 200
   (c) wealth in the economy increases by Rs. 1000
   (d) the money supply eventually decreases by Rs. 5000

9. A reduction in oil price is likely to cause
   (a) an economic expansion with higher inflation
   (b) a recession with higher inflation
   (c) an economic expansion with lower inflation
   (d) a recession with lower inflation

10. Suppose there is full employment and aggregate supply is vertical. A decrease in taxes
    (a) increases the price level and real output
    (b) increases the price level but has no effect on real output
    (c) increases real output but has no effect on the price level
    (d) has no effect on the price level or real output

SECTION - B

True/False/uncertain   (10Marks)

1. It is impossible for a real GDP increase to be coupled with a decrease of nominal GDP.

2. The growth of nominal GDP per capita is the best summary measure of changes in material living standards in a country over time.

3. When MPC increases and investment demand decreases, goods market equilibrium output increases.

4. If demand for money increases and monetary authorities want interest rates to remain unchanged, buying bonds in the open market would be an appropriate policy

5. The bond that offers the highest returns has to be the most expensive one.

6. A monetary expansion is more effective in changing the interest rate when money demand is very sensitive to the interest rate.

7. In terms of changing output, monetary policy is relatively more effective when the IS curve is relatively flat, while fiscal policy is more effective when the IS curve is relatively steep.

8. Monetary contraction and fiscal expansion together lead to an increase in equilibrium output and interest rate.

9. Suppose there is a decrease in the price level from P to P^1. Given the stock of nominal money, M, this leads to an increase in the real money stock M/P, which shifts the LM curve down. This implies that the AD curve shifts to the right.

10. If aggregate supply is positively sloped, an increase in government expenditure along with an increase in money supply would result into increases in real income and price, and uncertain changes in interest rate.

SECTION - C

1. The following data is given for an economy:

   Total population :   1,000,000

   Labor force   :   500,000

   Numbered of employed   450,000

   Calculate the unemployment rate. If 200,000 persons migrate to a neighboring country, what happens to the unemployment rate?   **(2)**

2. True/False/Uncertain. Explain your answer.

(a) The higher the levels of the government spending and taxation at which a deficit of a given size occurs, the greater will be its expansionary impact upon the economy.

(b) Gaurav lives in the US, and his salary there is $25,000 per year. Suppose he is offered to move to France where his salary would be $30,000. Assume that the two jobs he will be doing are completely identical. Gaurav should move, because he is going to get a higher salary.   **(4)**

3. Suppose we have an economy described by the following functions.

   $C = 200 + 0.75\ Y_D$

   $I^* = 150 + 0.05\ Y - 1000\ i$

   $T = 200$

   $G = 250$ $M_s / P = 1600$

   $M_s/P = 2Y - 8000\ i$

(a) Derive the IS equation
(b) Derive the LM equation
(c) Solve for equilibrium real output and interest rate
(d) There is sudden drop in consumer confidence and consumption function becomes $C = 100 + 0.75\ Y_D$. How can the government counterbalance the drop in GNP using government spending as a policy instrument?. And using taxes as a policy instrument?   **(5)**

4. A Keynesian government is up for re-election soon, and so it wants to increase output using expansionary policies. Propose two different policy options that would do the job. For each policy option, draw the IS – LM and the AS – AD diagrams. **(3)**

5. Explain carefully what is meant by aggregate supply curve. Describe the difference between classical and Keynesian views of aggregate supply curve. **(3)**

6. Write shot-notes on any three of the following:
   (a) Stagflation
   (b) Demand-pull inflation
   (c) Crowding-out
   (d) Moral suasion
   (f) Law of diminishing returns **(3)**