

**MAJOR EXAMINATION, HUL 213**  
**DEPARTMENT OF HUMANITIES AND SOCIAL SCIENCES**  
**Maximum Marks- 40 Marks**  
**23<sup>rd</sup> November 2015; Time: 01.00 PM - 3.00 PM**

**SECTION-A**

**Multiple Choice Questions. Only one option is correct. [10 marks]**

- 1. Which of the following will most likely shift the production possibility curve to the right?**
  - a) shifting resources from butter to gun production
  - b) a decline in the size of the population and labor force
  - c) a sudden and substantial expansion in consumer wants
  - d) an improvement in the literacy level and general level of education
- 2. Suppose an economy is now operating at full employment and non-inflationary output level and the MPC is 0.75. the central government now finds that it must increase spending on military goods to Rs.90 billion in response to changing international political situation. In order to sustain full employment non-inflationary output level, the government must**
  - a) reduce taxes by Rs.90 billion
  - b) increase taxes by Rs.120 billion
  - c) increase taxes by Rs.90 billion
  - d) reduce taxes by Rs.120 billion
- 3. The asset demand for money is most closely related to money functioning as a**
  - a) Standard of value
  - b) Store of value
  - c) Medium of exchange
  - d) Unit of account
- 4. Given  $C = 40 + 0.8(Y_d)$ ,  $T = 20$ ,  $G = 20$  and  $I^* = 70 - 400i$ , a Rs.10 increase in taxes will shift the IS curve**
  - a) to the right by Rs.10
  - b) to the left by Rs.10
  - c) to the right by Rs.40
  - d) to the left by Rs.40
- 5. In which of the following situations will an increase in the money supply have no effect on output?**
  - a) LM is relatively steeply sloped and IS is relatively flat
  - b) LM is vertical and IS is steeply sloped
  - c) LM is steeply sloped and IS is vertical
  - d) LM is relatively flat as is IS
- 6. If the quantity of money demanded exceeds the quantity supplied**
  - a) the demand for money curve will shift to the right
  - b) the demand for money curve will shift to the left
  - c) the supply of money curve will shift to the right
  - d) none of the above
- 7. When the aggregate supply curve is positively sloped, continuous increase in the nominal money supply will result in**

- a) no change in the price level and proportional increases in real output
  - b) no change in real output and proportional increases in the price level
  - c) an increase in the price level and real output
  - d) an increase in the price level and a decrease in real output
8. When aggregate supply is positively sloped and there is an increase in the per unit cost of materials, aggregate supply shifts
- a) rightwards, the price level falls, and the output increases
  - b) leftward, the price level falls, and output increases
  - c) rightward, the price level increases and output decreases
  - d) leftward, the price level increases and output decreases
9. When there is full employment and aggregate supply is vertical, a decrease in taxes
- a) increases the price level and real output
  - b) increases in 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
10. When aggregate supply is positively sloped and there is an increase in the per unit cost of materials, aggregate supply shifts
- a) rightwards, the price level falls, and the output increases
  - b) leftward, the price level falls, and output increases
  - c) rightward, the price level increases and output decreases
  - d) leftward, the price level increases and output decreases

### SECTION-B

[9 marks]

State whether the statement is TRUE or FALSE.

1. A person grows tomatoes for home consumption. This activity is excluded from GNP in order to avoid double counting.
2. There is an inverse relationship between the value of income tax rate and the value of the expenditure multiplier
3. An annually balanced budget is counter cyclical because tax revenue reductions associated with recessions will require cuts in government spending
4. If an economy is experiencing inflation, then to reduce inflation rate, policymakers should increase interest rates.
5. Crowding out is more likely to occur when the demand for money is interest-insensitive, and private sector investment spending is interest sensitive.
6. The slope of the aggregate demand becomes steeper the more sensitive investment spending is to the rate of interest.
7. When labor demands a higher nominal wage, other things remaining the same, output decreases and the price level increases.
8. In an aggregate-demand-aggregate-supply diagram, cost push inflation is shown by leftward movement of the aggregate supply curve.
9. If the major source of inflation is "cost push", then the need for and the effectiveness of monetary and fiscal policy to control inflation are increased.

## SECTION-C

1. Given a three-sector model where:

$$C = 100 + 0.80Y_d$$

$$I^* = 132 - 600i$$

$$G = 50$$

$$T = 40$$

$$X = 30$$

$$M_s = 200$$

$$L = 50 + 0.20Y - 400i$$

$$P = 1$$

where  $L$  is the demand for money in real terms

(a) Find the equilibrium levels of income and interest

(b) What impact will a 25% increase in the price level have on equilibrium output and interest rate

[5 marks]

2. (a) If the government hires a completely useless paper shuffler, GDP increases, but if Tata Motors hires this person, GDP remains unchanged. Is this correct? Explain your reasoning.

(b) Suppose the current exchange rate between the United States and India is 65 rupees to a dollar. If you are an American planning a vacation in India, would you prefer the PP exchange rate to be 20 rupees per dollar or 80 rupees per dollar? Give your reasoning.

[2+2 Marks]

3. What happens to the interest rates as we move down the aggregate demand curve, and why?

[2 marks]

4. In the debates related to the current economic situation in the country, some economists argue that the RBI should undertake policies to ensure low inflation. Other economists oppose such policies, arguing that RBI's restrictive policies will only slow down economic growth and are not likely to have any effect on inflation. What are your views? Explain in detail.

OR

A government attempting to tackle the current economic slowdown wants to increase output using Keynesian policies. Propose two policy options that would do the job and analyze their impact on employment, prices and interest rate. For each policy option, draw the IS-LM and AS-AD diagrams.

[4 marks]

5. What role does the assumption of downward rigidities of nominal wages play in the derivation of Keynesian aggregate supply curve? Show the derivation using a graph.

[4 marks]

6. Write short notes on any three of the following:

a) Law of diminishing returns      b) Stagflation      c) Transfer payments  
d) Barter systems      e) Adverse selection

[3 marks]