

DEPARTMENT OF HUMANITIES AND SOCIAL SCIENCES

HUL-213 Macroeconomics

Major Test (II Semester, 2006-07)

Date: 03.05.2007

Max. Marks: 40

Time: 10.30 am to 12.30pm

Section – A

Multiple – Choice questions (10 marks) (only one option is correct)

1. The difference between the profit of a teashop and that of WIPRO is that
 - (a) the former is included in GDP while the latter is not
 - (b) the former is not included in GDP while the latter is
 - (c) the whole profit of the teashop is included in personal income but that of WIPRO is not
 - (d) there is no difference
2. If the economy is experiencing a recession then the government is likely to improve the economic performance of the economy by:
 - (a) reducing government spending
 - (b) redistributing income to achieve income equality
 - (c) decreasing tariffs on imported goods
 - (d) reducing taxes
3. When the RBI purchases a Rs. 1000 bond from a commercial bank (BankA). Then
 - (a) Bank A's total reserves rise by Rs. 1000
 - (b) Bank A's excess reserves rise by Rs. 1000
 - (c) Bank can safely lend Rs. 1000
 - (d) All of the above
4. The intercept of the IS curve varies inversely with
 - (a) Government expenditure
 - (b) Interest sensitiveness of investment
 - (c) Money supply
 - (d) Marginal propensity to save
5. According to liquidity trap argument,
 - (a) expansive monetary policy loses its power once interest rates fall to low levels.
 - (b) restrictive monetary policy loses its power once interest rates fall to low levels.
 - (c) Fiscal policy can fall into a trap if too much attention is paid to the liquidity of banks
 - (d) Fiscal policy can fall into a trap if too little attention is paid to the liquidity of banks
6. A money supply increase shifts LM rightward, with the actual change in output closely approximating the shift of LM when
 - (a) LM is steeply sloped and IS is steeply sloped
 - (b) LM is relatively flat as is IS
 - (c) LM is steeply sloped and IS is relatively flat
 - (d) LM is relatively flat and IS is steeply sloped.

7. The slope of aggregate demand becomes flatter
 - (a) the more sensitive investment spending is to the rate of interest
 - (b) the less sensitive investment spending is to the rate of interest
 - (c) the larger the value of Government expenditure
 - (d) the larger the nominal money supply
8. When aggregate supply is positively sloped and there is a decrease in profit margins, aggregate supply shifts
 - (a) leftward, the price level falls, and real output increases
 - (b) rightward, the price level falls, and real output increases
 - (c) leftward, the price level increases, and real output decreases
 - (d) rightward, the price level increases, and real output decreases
9. When there is full employment and aggregate supply is vertical, an increase in government spending
 - (a) pushes up the rate of interest, which changes the composition of output
 - (b) increases the real money supply, which changes the composition of output
 - (c) has no effect on the real money supply or the composition of output
 - (d) has no effect on the rate of interest or the composition of output.
10. The policy dilemma posed by stagflation is that
 - (a) the adjustment of aggregate demand can neither increase GNP nor reduce inflation
 - (b) tax rates can be reduced without lowering tax revenue
 - (c) an increase in aggregate demand will increase inflation and the unemployment rate simultaneously
 - (d) the reduction of aggregate demand to restrain inflation will cause a further reduction in the real GNP

Section-B

True – False (10 marks)

1. If there is an increase in labour force of a country, the production possibility curve will shift outward, but it is not necessary that the country will produce more goods and services.
2. People who have borrowed large sums generally gain from unanticipated inflation.
3. Many workers have lost their jobs due to installation of computers which they do not know how to operate. This is not cyclical but frictional unemployment.
4. If taxes are given $T = -100 + 0.2 Y$, rich people pay lower taxes for each rupee of income than poor people.
5. The higher the levels of government spending and taxation at which a deficit of a given size occurs, the greater will be its expansionary impact on the economy.
6. Assume that the cash reserve ratio for the commercial banks is 10%. If the RBI buys Rs. 50 million of government bonds from commercial banks, we can say that, as a result of this transaction the supply of money is unaffected, but the lending ability of the banking system is increased by Rs. 500 million.

7. An increase in imports shifts the aggregate supply curve leftward and thus reduces equilibrium output.
8. According to the Keynesians, aggregate supply is positively sloped because as price level decreases, real wages increase that leads to increase in quantity of labour supplied.
9. A reduction in oil price is likely to cause an economic expansion with lower inflation but its effect on interest rate is uncertain.
10. If the economy is operating in the classical range of the aggregate – supply curve, it would be appropriate policy to restrain aggregate demand.

Section C

1. If two countries were to join as a single country, what would be the effect on their total GNP (assuming that output in each country is unaffected). Would any of the component in their GNP change significantly? (3)
2. The following equations describe the economy:

$$C = 0.8(1 - t)y$$

$$t = 0.125$$

$$I^* = 400 - 1000i$$

$$\bar{G} = 300$$

$$\bar{X} = 250$$

$$M = 50 + 0.1y$$

$$M_d = 0.25y - 1500i$$

$$\bar{M}_s = 350$$

$$P = 1$$

- (a) What are the equilibrium levels of income and interest rates?
- (b) By how much does an increase in government spending of 170 change
 - (i) the level of income
 - (ii) the interest rate
 - (iii) the trade balance

(6)

© Is there any crowding out here? Explain.

3. Explain carefully what is meant by aggregate supply curve. Describe the difference between Classical and Keynesian views of aggregate supply curve.

OR

Compare the effects of an expansionary fiscal policy action in the Keynesian and Classical models. Include in your answer the effects of this policy shift on the level of real income, employment, the price level, and the rate of interest. (4)

4. (a) Why is monetary policy ineffective in the “liquidity trap”? Explain. (2)
- (b) Give one reason for believing that CPI overstates the true rates of Inflation. (1)

© Is it possible for net investment to be negative during a year? Explain (1)

5. Write short-notes on any three of the following:-

- (a) Ability-to-pay Principle of Taxation
- (b) GNP Deflator
- (c) Efficiency wages
- (d) Statutory liquidity Requirement
- (e) Supply Shock

(3)