Indian Institute of Technology Bombay
Department of Humanities & Social Sciences
HS 101: Economics

Academic Year: 2018-19 | Semester II | Date: 25th April 2019
Max. Marks: 35 | End-Term Examination | Time: 5:30 - 8:00PM

Instructions: **This Question Paper has TWO Parts**: **Part A** and **Part B**. Note that, **Part A** contains "Subjective Type Questions"; while **Part B** contains "Objective Type Questions". Answer both the parts (A & B) in the *answer booklet*. You are advised to ***maintain the sequence of the question number while answering the objective type questions in* Part B**.

Part A — 25 Marks

I. Answer in *details* the following questions. *All Questions Are Compulsory.*

(a) Mention the *reasons* behind *business cycles*; point out the *possible causes* behind the *Great Depression* and state the *Okun's Law*. Give example of a *procyclical* variable and *countercyclical* variable. [2.5 + 1]

State the *drawbacks* of the *accelerator theory of investment*. [1.5]

(b) Open Market Operations and mechanism of monetary expansion under fractional reserve banking. [2.5 + 2.5]

(c) Consider the following details for the economy of *Indus Valley*. All notations carry their respective conventional meanings.

$GDP = \$6000$ $I = \$800$ $I^N = \$200$
$C = \$4000$ $G = \$1100$ and *Government Budget Surplus* of \$30

Calculate the following. {*You need to show the steps of computation*} [0.5 × 5]

(i) *NDP* (ii) *Net Exports* (iii) *Government Taxes Net of Transfers*
(iv) *Disposable Income* (v) *Savings*

Comment on the Savings – Investment gap in this economy.

(d) Assume that for the *Bohemian* economy you have the following details:

$GDP = \$6000$ *Disposable Income* = \$5100 *Trade Deficit* = \$100
$C = \$3800$ *Government Budget Deficit* = \$200

Then find out the following. {*You need to show the steps of computation*} [0.5 × 3]

(i) *Savings* (ii) *Investment* (iii) *Government Spending*

Comment on the Savings – Investment gap in this economy.

(e) *Explain the Vicious Cycle of Poverty. Critically evaluate GDP* as a measure of social well-being. [2.5 + 2.5]

(f) Define *briefly* the followings. [3 + 3]

(i) *Stagflation and Keynesian macroeconomics*

(ii) *Underemployment equilibrium in Keynesian macroeconomics*

Part B

[*Please maintain the sequence of the questions as given in the question paper while answering Pa*

For every *incorrect answer*, **0.5 marks** will be *deducted*.

II. Multiple Choice Questions:

Choose the only alternative that best answers the respective question. [20 × 0.5 =

1. Ando, Modigliani and Brumberg's consumption function specification suggests that

(a) $MPC_{Wealth} > MPC_{Income}$
(b) $MPC_{Wealth} < MPC_{Income}$
(c) $MPC_{Wealth} = MPC_{Income}$
(d) $MPC_{Permanent\ Income} > MPC_{Long\ run\ Wealth}$

2. A decrease in the '*user cost of capital*' will result in the production process becoming

(a) More capital intensive and the capital output ratio decreasing
(b) More capital intensive and the capital output ratio increasing
(c) Less capital intensive and the capital output ratio decreasing
(d) Less capital intensive and the capital output ratio increasing

3. Savings tend to _____ during boom time and _____ during recession.

(a) fall; fall (b) fall; rise (c) rise; fall (d) rise; rise

4. What problems are we most likely to see at which stage of the business cycle?

(a) High unemployment during recessions
(b) High unemployment during booms
(c) Low inflation during booms
(d) High inflation during recessions

5. In a two-sector model, when saving is $-40+0.20Y_d$ and investment is \$60, equilibrium output is

(a) \$100 (b) \$400 (c) \$500 (d) \$1000

6. In the *Keynesian Model*, if savings exceed intended (planned) investment then

(a) investment will rise
(b) output will remain the same
(c) output will fall
(d) savings will increase

7. Real *GDP*

(a) moves in the same direction as unemployment
(b) is not adjusted for inflation
(c) also measures real income
(d) all of these are correct

8. If net investment is zero, then

(a) capital consumption allowance is zero
(b) gross investment is greater than depreciation
(c) gross investment is less than depreciation
(d) gross investment equals depreciation

9. Keynes in his *AIH* conjectured that

(a) $MPC_{Rich} > MPC_{Poor}$
(b) $MPS_{Rich} > MPS_{Poor}$
(c) $MPC_{Rich} > APC_{Poor}$
(d) $MPC_{Rich} = APS_{Poor}$

10. A decrease in the lump-sum tax will

(a) make the consumption function steeper
(b) shift the consumption function downward
(c) make the consumption function flatter
(d) shift the consumption function upward

11. Possible sources of an upward bias in the *CPI* include the
(a) appropriate quantity adjustment bias
(b) substitution bias
(c) new products bias
(d) Both (b) and (c)
(e) All of the above

12. Which of the following items is *not* part of government expenditures in *GNP*?
(a) salaries of policemen
(b) welfare payment cheques
(c) the purchase of paper for printing ballots for conducting Elections
(d) the construction of national highways and strengthening the *Grameen Sadak Yojona*

13. The *Absolute Income Hypothesis* suggests that in the short-run
(a) MPC > APC
(b) APC > MPC
(c) $1 < APC < 0$
(d) $1 < MPC < 0$

APC - MPC > 0.

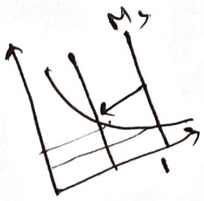
14. In an economy, measuring (1) total value added, (2) total spending on final goods and services, and (3) total factor earnings gives the result that
(a) $3 > 2 > 1$
(b) $3 = 2 = 1$
(c) $3 < 2 < 1$
(d) any measure can be larger or smaller than any other

15. Which of the following is most likely to take place when net investment is positive?
(a) Depreciation exceeds purchases of new capital
(b) A shortage of consumer goods
(c) A slowdown in economic activity
(d) The economy expands

I ↑ In

16. Assume that $C = c_0 + c_1(Y - Tx)$. Suppose that taxes increase and money supply increases in such a way that output is constant (unchanged) in equilibrium. These policy changes will produce
(a) An increase in investment and a decrease in government spending
(b) An increase in investment and a decrease in private consumption
(c) An increase in investment and an increase in private saving
(d) A decrease in investment and an increase in public saving
(e) Uncertain outcome

$Y = (C_0 + C_1 Y - C_1 T_x) + I + (G +$



$M_s \downarrow \Rightarrow r$

17. When money supply in the economy decreases
(a) interest rates fall and so aggregate demand shifts to the right
(b) interest rates fall and so aggregate demand shifts to the left
(c) interest rates rise and so aggregate demand shifts to the right
(d) interest rates rise and so aggregate demand shifts to the left

18. In the Keynesian theory, the demand for money is
(a) negatively related to the price level
(b) positively related to the interest rate
(c) negatively related to the interest rate
(d) positively related to the income level
(e) positively related to both income and interest rate
(f) only (c) and (d) are true.

$M^d = K_1 Y - K_2 r$

19. The *labor-force participation rate* measures the percentage of the

(a) adult population that is in the labor force
(b) total adult population that is employed
(c) labor force that is employed
(d) labor force that is unemployed.

20. Which of the following sequence of events will follow if there is an increase in government expenditures? (where AE is aggregate expenditures and Y is output / income)

(a) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M_d\uparrow \Rightarrow r\uparrow \Rightarrow I\uparrow$
(b) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M_d\downarrow \Rightarrow r\uparrow \Rightarrow I\downarrow$
(c) $AE\downarrow \Rightarrow Y\downarrow \Rightarrow M_d\downarrow \Rightarrow r\uparrow \Rightarrow I\uparrow$
(d) $AE\uparrow \Rightarrow Y\uparrow \Rightarrow M_d\uparrow \Rightarrow r\uparrow \Rightarrow I\downarrow$

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