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Indian Institute of Technology Bombay
Semester I [2014-15]
End-Term Examination of HS 101: ECONOMICS
Date: 11/11/2014

Full Marks: 50 Time:17.30-20.30 Hrs

Answer All Questions

QI. Write short notes on ANY THREE of the following. [3×5 = 15 Marks]

1. Business Cycle
2. Aggregate Demand Curve
3. Demand-Pull Inflation
4. Demand for Money
5. Keynesian Multiplier
6. Instruments of Monetary Policy

QII. Answer ANY ONE of the following. [1×5 = 5 Marks]

1. Use a graph to demonstrate why a profit-maximizing monopolistically competitive firm must operate at excess capacity. Explain why a perfectly competitive firm is not subject to the same constraint.

2. Using indifference curves and budget constraints, graphically illustrate the substitution and income effect that would result from a change in the price of a normal good.

QIII. Choose the *right alternative* in case of the following. [30×0.5=15 Marks]

(Instructions: There is ***only one answer*** to each of the following questions.)

1. Which statement is *false* regarding Keynesian theory of consumption?
   a) APC + APS = 1
   b) APC rises as income increases
   c) APS rises as income increases
   d) MPC is a proper fraction

2. Investment spending increases whenever
   a) Output growth decelerates
   b) Interest rate decreases
   c) Interest rate increases
   d) Business houses are pessimistic

3. Real GDP increases when
   a) there is an increase in the price level.
   b) there is an increase in the population.
   c) there is an increase in the output of goods and services.
   d) there is an increase in the real wage

4. Which of the following cannot co-exist in the Keynesian model?
   a) Voluntary unemployment and tight money policy
   b) Involuntary unemployment and full employment equilibrium
   c) High inflation and high unemploy simultaneously
   d) Speculative demand for money

5. Falling output and rising price is known as
   a) Inflation
   b) Deflation
   c) Stagflation
   d) Recession

6. Which of the following is not an item of transfer payment?
   a) Old-age Pension
   b) Scholarship
   c) Dividend
   d) Subsidy

7. Which of the following does not increase output?
   a) An increase in the supply of labour, *ceteris paribus*
   b) There is a technological advancement in the economy, *ceteris paribus*
   c) Government imposes new environmental laws, *ceteris paribus*
   d) There are new innovations and improved methods for managing resources, *ceteris paribus*

8. In a two-sector model, the savings function is $S = -40 + 0.20Y_d$ where Y_d is disposable income; and investment is $I = 60$. Then the equilibrium disposable income will be
   a) 100
   b) 400
   c) 500
   d) 1000

$Y_d = C + S$

$60 + 40 = 0.2Y_D$

$S = I$

9. The appropriate (Keynesian) fiscal policy to remedy a recession
   a) calls for the central government to have deficit spending
   b) calls for the central government to run a budget surplus
   c) is decreased government spending and taxes
   d) is increased taxes and reduced government spending

10. Which of the following would shift the aggregate demand curve to the left?
   a) An increase in the consumer confidence
   b) Firms expect lower sales in near future
   c) Foreigners develop a preference for our domestic products
   d) An increase in the money supply in the economy

$X - M$

11. In the short-run Keynesian model, at the break-even point
   a) The expenses of corporations just equal their total revenues
   b) Government spending equals government tax revenue income
   c) Total (aggregate) spending equals total national income
   d) Saving occurs and inventories are accumulating

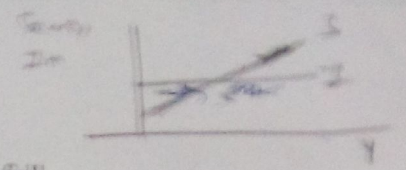
12. When there is full employment and aggregate supply is positively sloped, a decrease in taxes increases
   a) the price level and real wage
   b) the price level and output
   c) output but has no effect on the price
   d) the price level and government spending

13. Keynesian Transaction Demand for Money is
   a) positively sloped in nominal interest rate - money demand space.
   b) positively sloped in real interest rate - money demand space.
   c) ~~positively~~ sloped in nominal interest rate - money demand space. negatively
   d) positively sloped in income - money demand space.

$Y_D \uparrow$

14. With more of financial innovation (like ATM), the money demand curve
   a) becomes steeper.
   b) shifts to the right.
   c) shifts to the left.
   d) becomes vertical.

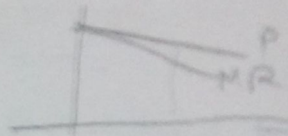
15. Lower (but not zero) the interest rate, you would hold
   a) more bonds and fewer money.
   b) fewer bonds and more money.
   c) only bonds.
   d) equal amount of money and bonds.



16. In the Keynesian Model, if savings exceed intended investment then
    a) output will rise.
    b) output will remain the same.
    c) output will fall.
    d) savings will increase.

17. Product differentiation causes the seller of a good to face what type of demand curve?
    a) Downward sloping
    b) Vertical
    c) Horizontal
    d) Any of the a), b), and c) could be correct since product differentiation does not affect the shape of the demand curve.

18. For a profit-maximizing monopolist,
    a) P > MR = MC.
    b) P = MR = MC.
    c) P > MR > MC.
    d) MR < MC < P.



19. An oligopoly is a market in which
    a) firms are price takers.
    b) there are only a few sellers, each offering a product similar or identical to the products offered by other firms in the market.
    c) the actions of one seller in the market have no impact on the other sellers' profits.
    d) there are many price-taking firms, each offering a product similar or identical to the products offered by other firms in the market.

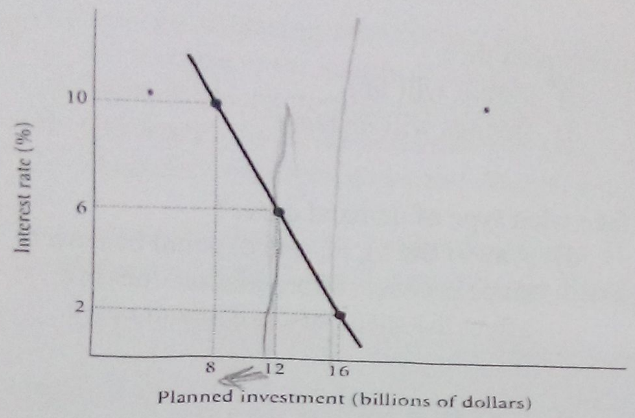
20. Average total cost equals
    a) change in total costs divided by quantity produced.
    b) change in total costs divided by change in quantity produced.
    c) (fixed costs + variable costs) divided by quantity produced.
    d) (fixed costs + variable costs) divided by change in quantity produced.

21. Price controls
    a) always produce an equitable outcome.
    b) always produce an efficient outcome.
    c) can generate inequities of their own.
    d) produce revenue for the government.

22. A family on a trip budgets $800 for meals and hotel accommodations. Suppose the price of a meal is $40. In addition, suppose the family could afford a total of 8 nights in a hotel if they don't buy any meals. How many meals could the family afford if they gave up two nights in the hotel?
    a) 1
    b) 2
    c) 5
    d) 8

23. Which of the following is NOT a component of GDP?
    a) New exports
    b) Government purchase
    c) Purchase by consumers of used goods
    d) Purchase by consumers of finished goods

24. A radiologist buys a new X-ray machine from central electric to use in her medical practice. The X-ray machine is included in the GDP as
    a) Investment
    b) Consumption
    c) Service
    d) Nondurable consumption



25. Refer to the above figure. Planned investment could decrease from $12 million to $8 million if
    a) the government increases government purchases
    b) the RBI buys bonds in the open market.
    c) the government increases subsidies
    d) Both (b) and (c)

$M^S \downarrow$ Govt. selling

26. If GNP is $500 billion, receipts of factor income from the rest of the world are $ 15 billion, and payments of factors income to the rest of the world are $ 5 billion, then GDP is
    a) $ 510 billion
    b) $ 490 billion
    c) $ 500 billion
    d) $ 520 billion

NFIA = 15 − 5
GNP = GDP + 10

27. When there is full employment and the long run aggregate supply is vertical an unanticipated increase in money supply will result in
    a) Increase in output and price
    b) Increase in price but not output
    c) Increase in output but not price
    d) Neither price nor output increases

28. The fall in agricultural supply usually has an impact on industrial production. This is regarded as:
    a) Cost push inflation
    b) Demand pull inflation
    c) Deflation
    d) neither (a) nor (b)

29. One of the followings is *not* the function of Central Bank of a country
    a) Clearing house
    b) Lender of the last resort
    c) Bankers' bank
    d) Maintaining budget surplus

30. Which of the following sequence of events follows an *expansionary fiscal policy*?
    a) $AD\downarrow \Rightarrow Y\uparrow \Rightarrow M^d\downarrow \Rightarrow r\downarrow \Rightarrow I\downarrow \Rightarrow AD\downarrow$
    b) $AD\uparrow \Rightarrow Y\uparrow \Rightarrow M^d\downarrow \Rightarrow r\downarrow \Rightarrow I\downarrow \Rightarrow AD\downarrow$
    c) $AD\uparrow \Rightarrow Y\uparrow \Rightarrow M^d\uparrow \Rightarrow r\uparrow \Rightarrow I\downarrow \Rightarrow AD\downarrow$
    d) $AD\downarrow \Rightarrow Y\downarrow \Rightarrow M^d\downarrow \Rightarrow r\downarrow \Rightarrow I\uparrow \Rightarrow AD\uparrow$

QIV. State whether the following statements are TRUE or FALSE. [30 × 0.5 = 15 Marks]

1. When the RBI carries out a contractionary monetary policy through open market operation, it raises the price of bonds, and lowers the output level. F
2. Major macro variables such as 'employment' and 'output' move together but in opposite direction. F

MPS 1 $\frac{\Delta S}{\Delta I}$ 1

3. The larger the marginal propensity to save, the greater the Keynesian government expenditure multiplier. False
4. If everyone increases their marginal propensity to save, the Keynesian model predicts that total saving will fall. F
5. In an open economy, the government spending multiplier will be lower than in an economy without international trade. T
6. Fiscal policy refers to actions by the government to control the supply of money and interest rates that directly influence the financial markets. F
7. GNP counts goods and services produced within the country's borders, regardless of who produced it. F
8. GDP has three components: consumption, investment, and net exports. F
9. An increase in the level of income will cause the demand for money to increase. T
10. A commercial bank's reserves consist of its vault cash and its deposits at the RBI/Fed. F
11. A profit-maximizing firm in a monopolistically competitive market always prices its product at some markup over marginal cost. T
12. If all of the oligopolists in a market collude to form a cartel, total profit for the cartel is less than that of a monopolist. F
13. A competitive market will typically experience entry and exit until accounting profits are zero. F
14. Giffen goods are inferior goods for which the income effect dominates the substitution effect. T
15. A shortage will occur at any price below equilibrium price and a surplus will occur at any price above equilibrium price. T
16. Full-time students, retirees, and unpaid stay-at-home fathers are counted as unemployed. F
17. Frictional unemployment exists because of the time it takes for workers to search for the jobs that best suit their tastes and skills. T
18. Inflation causes the real income of workers to go down. T
19. The broadest definition of money supply is given by M_1. F
20. The roots of monetarism can be traced in the equation of exchange given as part of the quantity theory of money. T
21. Monetary policy consists of only long term measures. F
22. Keynesian economics completely denies the role of government intervention. F
23. A stable and moderate rate of inflation is considered good for the economy. T
24. If there is no commercial bank, the money multiplier process will not operate. T
25. There are more than three primary functions of money. F
26. By lowering CRR, RBI decreases the money supply in the economy. F
27. Barter economy operated on double coincidence of wants. T
28. Real interest rate is equal to nominal interest rate *plus* inflation rate. F
29. When the economy is under *liquidity trap*, the central bank of a country should undertake an expansionary monetary policy. T
30. Depression decreases the demand for money. F

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