

Department of Humanities and Social Sciences, Indian Institute of Technology Bombay
 HS 101 Principles of Economics Course
 Instructor: Haripriya Gundimeda
 End Semester Examination, 16/11/2018

1. The Question Paper has 4 sections.
2. Please read the questions carefully and answer the questions in the spaces provided.
3. For Section 4 you can take a supplementary sheet
4. No academic malpractices are permitted in the examination. If found, stringent action would be taken
5. No mobile phones are permitted in the examination

Total Marks - 45

Section A. This section carries 13 Marks
 (Answer in the spaces provided)

①

I Based on the information given below, Compute the following aggregates

Macroeconomic Aggregate	Value (in Rs. 000 Crores)
Gross value added at basic prices	10490
Taxes less subsidies on products including import duties	890
Consumption of fixed capital	11381
Household consumption expenditure	----
Government expenditure	1226
Gross capital formation (Investment)	4023
Exports	2378
Imports	2510
Net primary income received from abroad	-134
Personal income	10497
Current taxes paid by household on income and wealth	275
GDP deflator	1.18

- 1 GDP using value added approach
- 2 Household Consumption expenditure
- 3 Net Domestic Product
- 4 Household disposable Income
- 5 Gross National Income
- 6 Real GDP

II. Based on the information below, answer the questions below (7 and 8)

	Billion Rupees
Currency in circulation with public	13004
Bankers deposits with RBI	3567
Other's deposits with RBI	97
Bank's demand deposits	8142
Bank's time deposits	77963
Other Deposits with RBI	96

Based on the information above. Compute the following

7	Reserve Money (M0)	13004 Billion ₹
8	Broad Money (M3)	

9	Based on GDP and M3 you computed in the above, compute the income velocity of money	1
10	As income level increases from ₹500 to ₹1,000, consumption increases from ₹700 to ₹1,100. The marginal propensity to consume equals	-25% ✓
11	The CPI for 2010 is 105, and the CPI for 2011 is 110. The rate of inflation is	4.76% ✓
12	In a closed economy, If disposable income is 4000, the consumption is 3500, government spending is 1000, and tax revenues are 800, national saving is	-500 ✓
13	A bank has demand deposits of ₹100,000 and actual reserves of ₹27,000. If the reserve requirement is 10 percent, the bank can loan out a maximum of	117,000 ✓

Section B - Answer the following briefly (carries 10 marks)

1. "Ford sells a Mustang from its inventory" - which component of GDP (if any) would increase?

✓ The items in inventory get added to Investment when it gets sold. Investment decreases by the price of car & consumption increases by the same amount. Net effect - GDP remains the same.

2. Your family takes a loan for buying a house - Is this an investment or saving? Why?

✓ As we know, every property related transaction is counted in investment here, it will be an investment. *not always*

3. A stock market boom induces newly enriched 60 year old workers to retire early - what happens to unemployment rate?

✗ The old workers will retire reducing working population & move to not looking for job as a result unemployment rate will fall.

4. Plastic Credit cards are classified as money. Tell briefly why this statement is true or false.

✓ This statement is false for anything to be money they need to be true with 3 things - a unit of account, store of value,

5. "Inflation hurts borrowers and helps lenders, because borrowers must pay a higher rate of interest. - Is this true or false?

✓ True, as inflation everything's price rises people need more money to buy things hence at this moment lenders take advantage of the same.

6. Retail inflation, rose to 10 per cent in 2012-13 and declined only marginally to 9.4 per cent in 2013-14. How is retail inflation measured?

7. The current account deficit was 1.3 per cent of GDP in 2012. What is current account deficit?

Current account deficit is what the public saving is if the government spending is more than the taxes they collect they get budget deficit.

- 8 The global financial crisis of September 2008 took a toll on the Indian economy and the government was forced to increase spending and provide fiscal stimulus to manage the fallout. How can the Government spending help?

- 9 "If firms adjusted their prices every day, then the short-run aggregate-supply curve would be horizontal. State True or False and why?"

- 10 A decreased job opportunities in US because of tough visa regulations, causes many people to return back. Would this affect the aggregate demand, aggregate supply or both?

It would affect both!

5.5

Section III (Carries 10 Marks)

(There is only one right answer. Please mark your answer legibly. No overwriting is permitted)

		Answer
1	Which of the following statements about FIAT MONEY are TRUE:	
	A Fiat money is backed, i.e., it is collateralized by some precious commodity.	
	B Fiat money is legal tender – i.e., by law, citizens must accept it as repayment for debts.	
	C Fiat money must necessarily be issued by a government.	
	D All of the above.	D
2	The use of a pure barter system in place of a pure monetary payment system tends to DECREASE efficiency because	
	A It encourages people to specialize in the production of goods for which they have a comparative advantage.	
	B It increases the number of prices needed to support trading (assuming the economy has four or more tradeable goods)	B
	C It increases the need to rely on "double coincidence of wants"	
	D Only B and C above	
3	If the aggregate price level were to DECREASE by 50%, then (all else equal) the real value of a rupee would	
	A. Double (increase by 100%).	A
	B. Decrease by 50 percent.	
	C. More than double.	
	D. Increase by 50%.	
4	By definition, a RECESSION is a period of time during which	
	A Inflation is high	
	B. The real money supply is low	
	C. Real GDP is declining	C
	D. Real wages are low	

- 5 Which of the following is an example of active fiscal policy?
- A. Increase in Government expenditures during a recession as unemployment insurance claims increase
- B. Fall in income tax collection during a recession as a result government runs a budget deficit
- C. Imposing a tax cut after the recession begins with the aim of stimulating the economy
- D. None of the above
- 6 Which of the following is NOT one of the components of aggregate demand?
- A. Consumption spending
- B. Investment spending
- C. Money supply
- D. Net exports
- 7 Which of the following is not included in a country's Gross Domestic Product (GDP)?
- A. the value of final goods sold
- B. the value of final services sold
- C. the value of government expenditures
- D. the value of household production in the economy
- 8 An increase in the minimum wage will likely
- A. increase structural unemployment.
- B. decrease structural unemployment.
- C. increase frictional unemployment.
- D. decrease frictional unemployment.
- 9 Which of the following statements is consistent with the theory of liquidity preference?
- A. Interest rates fall when RBI increases the money supply faster than usual
- B. When the RBI increases the money supply faster than usual, interest rates rise.
- C. Increases in money supply faster than usual does not change the interest rates in the short run but results in higher inflation.
- D. Increase in the money supply faster than usual, but does not change the interest rates in the short run but decreases the cost of living.
- 10 If nominal wages adjust slowly to changing economic conditions, then a decrease in the price level will cause the real wage rate to rise and employment and real output to fall. This description of the impact of a decrease in the price level on real output is used to explain:
- A. a shift in the aggregate-demand curve.
- B. the negative slope of the aggregate demand curve.
- C. the vertical shape of the long-run supply curve.
- D. the positive slope of the short-run aggregate-supply curve.
- 11 According to the theory of "money neutrality" which of the following statements is likely to be true?
- A. When the money supply is increased, real wage rates will rise.
- B. When the money supply is increased, real interest rates will fall.
- C. When the money supply is increased, real wage rates will fall.
- D. When the money supply is increased, nominal wage rates will rise.
- 12 The event which would not cause a rightward shift in the short-run aggregate-supply curve
- A. a change in labor laws that facilitates labor mobility and raises the productivity of workers.
- B. the invention of a new and more powerful computer chip that increases productivity throughout the economy.
- C. a war that reduces the economy's physical capital stock.
- D. new educational advances that substantially increase the level of human capital.
- 13 An increase in the price of goods bought by firms and government will show up in
- A. the CPI but not the GDP deflator
- B. the GDP deflator but not the CPI
- C. both the CPI and the GDP deflator
- D. neither the CPI nor the GDP deflator

14	National Saving is		
A	Private saving	C	✓
B	Public saving		
C	Private saving plus public saving		
D	Private saving minus public saving		
15	Which of the following is an example of transfer payment?		
A	Pension	A	✓
B	Wage		
C	Salary		
D	Income tax		
16	If the government spending exceeds taxes, the government budget is		
A	Balanced	C	✓
B	in surplus		
C	in deficit		
D	Increasing		
17	Which of the following would result in the largest increase in aggregate demand?		
A	A ₹ 30 crore increase in defense expenditure and a ₹30 crore open market purchase of Govt. securities	A	✓
B	A ₹ 30 crore increase in defense expenditure and a ₹30 crore open market sale of government securities		
C	A ₹30 crore tax decrease and a ₹30 crore open market sale of government securities		
D	A ₹30 crore tax increase and a ₹30 crore open market purchase of Govt. securities		
18	If equilibrium real GDP is less than its long run level	D	✓
A	There is a recessionary gap		
B	The economy is not in short-run macroeconomic equilibrium		
C	The economy is in a below full employment equilibrium		
D	Both (a) and (c) are correct		
19	Which of the following would most likely lead to a decrease in aggregate demand?		
A	A decrease in taxes	B	✓
B	A decrease in interest rates		
C	An increase in household savings		
D	An increase in household consumption		
20	As the economy nears full capacity, the short-run aggregate supply curve		
A	Becomes flatter	D	✓
B	Becomes steeper		
C	Shifts to the right		
D	shifts to the left		

Name

Roll Number

ANSWER any two. Those who missed the surprise quizzes on medical grounds can answer one extra question

Section 4 (2 x 6 = 12 marks)

1	Explain the three reasons for upward sloping Short run aggregate supply curve? And three reasons for downward sloping aggregate demand curve
2	<p>Use the AD-AS Model to answer this set of questions. Suppose you are given the following information:</p> <p>Long run aggregate supply (LRAS): $Y_f = 4000$ Short run aggregate supply (SRAS): $Y = 1000P - 10,000$ Aggregate demand (AD): $Y = 20,000 - 1000P$</p> <p>where Y is real GDP and P is the aggregate price level.</p> <p>a. Given the above information, find the short run equilibrium level of real GDP and the aggregate price level. b. Draw a graph representing the SRAS curve, the AD curve, and the LRAS curve. Label the short run equilibrium. c. Given your answers in (a) and (b), in this economy in the short run in a boom or a recession? Explain your answer. d. In the long run, holding everything else constant, what do you predict will happen in this economy?</p>
3	<p><u>Using the Macroeconomic concepts you learnt in the class, try and explain these phenomenon</u></p> <p>a. The Reserve Bank of India (RBI) in the last meeting kept the repo rate unchanged at 6.5 per cent counter inflationary pressures arising from the weak currency and high oil prices. Experts had largely expected the central bank to hike the repo rate by 25 basis points to counter inflationary pressures due falling rupee and rising oil prices. "The RBI has kept an inflation target of 4%, plus or minus 2%, and maintaining this range is its primary objective", said Urjit Patel, the Central bank's Governor..As of now the economy has declining retail food inflation, robust GDP growth, private consumption and investment has seen robust growth but the oil prices are high and rupee has weakened.</p> <p>a. Is this a fiscal or monetary policy? What is the likely impact of this and what would have been the impact of the hike by 25 basis points? What would be the rate hike on the output, employment and price levels? Show using appropriate diagrams.</p>
4	<div data-bbox="76 1323 655 1682" data-label="Figure"> <p>The figure consists of two line graphs. The top graph is titled 'GOVERNMENT EXPENDITURE' and shows a line with several peaks, with labels indicating election years (e.g., 1984, 1989, 1991, 1996, 2004, 2009, 2014). The bottom graph is titled 'INFLATION' and shows a line that generally follows the trend of the government expenditure line but with a lag, indicating that inflationary pressures build up after an increase in government spending.</p> </div> <div data-bbox="699 1323 1294 1682" data-label="Text"> <p>See the figure. A study of key economic variables over the past 30 years shows that economic activity lost pace significantly every time there was a general election. Government spending went up in an average election year. In the class you learnt the fiscal policy tools to spur growth. Can you explain why the govt. expenditure ahead of polls did not have the required multiplier impacts on the economy but had an inflationary impact?</p> </div>