

15 Solved Paper of ECO401

BY

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FINAL TERM EXAMINATION (1)

Fall 2009

ECO401- Economics (Session - 4)

Time: 120 min

Marks: 87

Question No: 1 (Marks: 1) - Please choose one

If the quantity demanded of a product is greater than the quantity supplied of a product, then:

- ▶ There is a shortage of the product.
- ▶ There is a surplus of the product.
- ▶ The product is a normal good.
- ▶ The product is an inferior good.

Question No: 2 (Marks: 1) - Please choose one

The cross price elasticity of demand for complementary goods is:

- ▶ Less than 0.
- ▶ Equal to 0.
- ▶ Greater than 0.
- ▶ Between 0 and 1.

Question No: 3 (Marks: 1) - Please choose one

Assume leisure is a normal good. If income effect equals substitution effect then a wage rate increase will lead a person to:

- ▶ Increase hours of work.
- ▶ Decrease hours of work.
- ▶ Not change hours of work.
- ▶ None of the given options.

Question No: 4 (Marks: 1) - Please choose one

_____ arises when an increase in all inputs leads to a more-than-proportional increase in the level of output. _____ means that as inputs are added to the production process, output increases proportionally.

- ▶ Economies of scale; constant returns to scale.
- ▶ Constant returns to scale; decreasing returns to scale.
- ▶ Decreasing returns to scale; economies of scale.
- ▶ Economies of scale; decreasing returns to scale.

Question No: 5 (Marks: 1) - Please choose one

An isoquant curve shows:

▶ **All the alternative combinations of two inputs that yield the same maximum total product.**

▶ All the alternative combinations of two products that can be produced by using a given set of inputs fully and in the best possible way.

▶ All the alternative combinations of two products among which a producer is indifferent because they yield the same profit.

▶ None of the given options.

Question No: 6 (Marks: 1) - Please choose one

Total costs are the sum of:

▶ Marginal costs and variable costs.

▶ **Fixed costs and variable costs.**

▶ Fixed costs and marginal costs.

▶ Average variable costs and marginal costs.

Question No: 7 (Marks: 1) - Please choose one

A firm is charging a different price for each unit purchased by a consumer. This is called:

▶ First-degree price discrimination.

▶ **Second-degree price discrimination.**

▶ Third-degree price discrimination.

▶ None of the given options.

Question No: 8 (Marks: 1) - Please choose one

Which of the following best expresses the law of demand?

▶ A higher price reduces demand.

▶ A lower price reduces demand.

▶ **A higher price reduces quantity demanded.**

▶ A lower price shifts the demand curve to the right.

Question No: 9 (Marks: 1) - Please choose one

If a sales tax on beer leads to reduced tax revenue, this means:

▶ Elasticity of demand is < 1 .

▶ **Elasticity of demand is > 1 .**

▶ Demand is upward-sloping.

▶ Demand is perfectly inelastic.

Question No: 10 (Marks: 1) - Please choose one

For a firm buying labor competitively, the marginal input cost is equal to the:

▶ **Wage.**

▶ Interest rate.

▶ Price of output.

▶ Cost of raw materials.

Question No: 11 (Marks: 1) - Please choose one

The classical economists thought that the economy would quickly overcome any short run instability because:

- ▶ Price level and quantity are flexible.
- ▶ Prices would get stuck at a low level.
- ▶ The long run aggregate supply would shift to the left.
- ▶ **Prices and wages are flexible.**

Question No: 12 (Marks: 1) - Please choose one

Final goods are meant for:

- ▶ **Direct use by the consumers.**
- ▶ Further processing.
- ▶ The term do not exist.
- ▶ None of the given options.

Question No: 13 (Marks: 1) - Please choose one

The average propensity to consume is the ratio of:

- ▶ **A change in consumption to a change in disposable income.**
- ▶ A change in consumption to total disposable income at a specific income level.
- ▶ Total consumption to total disposable income at a specific income level.
- ▶ Total consumption to a change in disposable income.

Question No: 14 (Marks: 1) - Please choose one

The slope of the saving function (or line) is the:

- ▶ Average propensity to save.
- ▶ Average propensity to consume.
- ▶ **Marginal propensity to save.**
- ▶ Marginal propensity to consume.

Question No: 15 (Marks: 1) - Please choose one

The government increases the number of job centres and uses more advanced computers to improve the information database. This creates:

- ▶ Structural Unemployment.
- ▶ Regional Unemployment.
- ▶ **Frictional Unemployment.**
- ▶ Demand Deficient Unemployment.

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Question No: 16 (Marks: 1) - Please choose one

Which one of the following can lead to a rise in inflation?

- ▶ **An increase in costs of production.**
- ▶ An increase in productive capacity.
- ▶ An increase in the level of direct taxation.

- ▶ An increase in the exchange rate.

Question No: 17 (Marks: 1) - Please choose one

What does the term "balance of payment deficit" refer to?

- ▶ An increase in official international reserves.
- ▶ A positive statistical discrepancy.
- ▶ A negative statistical discrepancy.
- ▶ **A decline in official international reserves.**

Question No: 18 (Marks: 1) - Please choose one

How should fiscal policy be used during inflation?

- ▶ Increase Government expenditure and decrease taxes to decrease aggregate demand.
- ▶ Increase Government expenditure and decrease taxes to increase aggregate demand.
- ▶ Decrease Government expenditure and increase taxes to increase aggregate demand.
- ▶ **Decrease Government expenditure and increase taxes to decrease aggregate demand.**

Question No: 19 (Marks: 1) - Please choose one

If the demand curve for a good is downward sloping, then the good:

- ▶ Must be inferior.
- ▶ Must be giffen.
- ▶ Can be normal or inferior.
- ▶ **Must be normal.**

Question No: 20 (Marks: 1) - Please choose one

Keeping in view the model of aggregate supply and aggregate demand, in the long run, an increase in the money supply should cause:

- ▶ **Both prices and output to rise.**
- ▶ Prices to fall and output to remain unchanged.
- ▶ Both prices and output to fall.
- ▶ Prices to rise and output to remain unchanged.

Question No: 21 (Marks: 1) - Please choose one

Which of the following is TRUE according to classical economists?

- ▶ **Aggregate demand curve is downward sloping and the aggregate supply curve is vertical.**
- ▶ Aggregate demand curve is downward sloping and the aggregate supply curve is upward sloping.
- ▶ Aggregate demand curve is vertical and the aggregate supply curve is upward sloping.
- ▶ Aggregate demand curve is vertical and the aggregate supply curve is horizontal.

Question No: 22 (Marks: 1) - Please choose one

Why calculations of Gross Domestic Product (GDP) count only final goods and services?

- ▶ Because it is difficult to measure the prices of intermediate goods produced.
- ▶ Because these are the only goods and services that are purchased in an economy.
- ▶ **Because counting all goods and services would lead to double-counting of many activities.**
- ▶ Because one cannot calculate the quantities of intermediate goods produced.

Question No: 23 (Marks: 1) - Please choose one

----- plays an important role in making sure that the economy reaches and stays at equilibrium at the potential output level.

- ▶ Real exchange rate.
- ▶ The production function.
- ▶ Real price level.
- ▶ **Real interest rate.**

Question No: 24 (Marks: 1) - Please choose one

Why a \$1 increase in government spending will have a larger impact upon national income than a \$1 tax cut?

- ▶ Because the government prints the currency it spends.
- ▶ **Because not all of the tax cut is spent.**
- ▶ Because when taxes are cut, government spending is also cut.
- ▶ Because taxes are an injection into the system.

Question No: 25 (Marks: 1) - Please choose one

Commercial banks in Pakistan are supervised by:

- ▶ **State bank of Pakistan.**
- ▶ National bank of Pakistan.
- ▶ Finance minister of Pakistan.
- ▶ World bank.

Question No: 26 (Marks: 1) - Please choose one

Trade can be beneficial in which of the following situations?

- ▶ Two countries produce the same goods at the same costs.
- ▶ **Two countries produce different goods at different costs.**
- ▶ Two countries are isolated.
- ▶ Two countries have the same markets.

Question No: 27 (Marks: 1) - Please choose one

Firm A produces cotton worth Rs. 1000 and sells it to firm B. From this, firm B makes yarn worth Rs. 1500 and sells to firm C. Firm C manufactures cloth worth Rs. 2500 and sells to consumers. The value added is:

- ▶ **1000+1500+2500 = Rs. 5000**
- ▶ 1000+500+2500 = Rs. 4000
- ▶ 1000+500+1000 = Rs. 2500
- ▶ 1000+1500+1000 =Rs. 3500

Question No: 28 (Marks: 1) - Please choose one

Which of the following best defines “subsidies”?

- ▶ Payment by Government for purchase of goods and services.
- ▶ Payment by business enterprises to factors of production.
- ▶ Payment by companies to share holders.
- ▶ **Payment by Government to business enterprises without buying any goods and services.**

Question No: 29 (Marks: 1) - Please choose one

National product at market prices incorporate:

- ▶ **Prices which buyers actually pay.**
- ▶ Payments made to the factor owners.
- ▶ Costs incurred in producing goods and services.
- ▶ Costs minus subsidies.

Question No: 30 (Marks: 1) - Please choose one

A marginal propensity to consume (MPC) of 0.95 indicates that:

- ▶ **ΔC to ΔY_d is 0.95.**
- ▶ C / Y_d is 0.95.
- ▶ ΔY_d to ΔC is 0.95.
- ▶ Y_d / C is 0.95.

Question No: 31 (Marks: 1) - Please choose one

When MPC is 0.80 and APC is 0.95 then MPS is:

- ▶ **0.20 and APS is 0.05.**
- ▶ 0.05 and APS is 0.20.
- ▶ 0.20 and APS is 0.20.
- ▶ 0.05 and APS is 0.05.

Question No: 32 (Marks: 1) - Please choose one

Which of the following are leakages from the circular flow?

- ▶ Consumption and saving.
- ▶ **Saving and imports.**
- ▶ Imports and exports.
- ▶ Exports and savings.

Question No: 33 (Marks: 1) - Please choose one

The time that a laborer uses for relaxation and all activities other than work or necessary sleep is known as:

- ▶ Free time.
- ▶ **Leisure.**
- ▶ Time not used for earning.
- ▶ All of the given options.

Question No: 34 (Marks: 1) - Please choose one

Labor supply curve is backward bending because:

- ▶ **The income effect of higher income dominates the substitution effect of higher wages.**
- ▶ The substitution effect of higher income dominates the income effect of higher wages.

- ▶ The income effect of higher income dominates the price effect of higher wages.
- ▶ None of the given options.

Question No: 35 (Marks: 1) - Please choose one

The government supports research in basic science because:

- ▶ It is a public good.
- ▶ External costs are created.
- ▶ **Internal benefits are created.**
- ▶ Free markets would do so otherwise.

Question No: 36 (Marks: 1) - Please choose one

In classical theory, excess supply of a product would be associated with:

- ▶ Rising interest rates.
- ▶ Falling interest rates.
- ▶ **Rising price for the product.**
- ▶ Falling price for the product.

Question No: 37 (Marks: 1) - Please choose one

Which of the following is NOT a determinant of net exports?

- ▶ Domestic and foreign incomes.
- ▶ Relative price levels.
- ▶ Domestic and foreign trade policies.
- ▶ **Producers' expectations about future prices.**

Question No: 38 (Marks: 1) - Please choose one

A trade surplus occurs when:

- ▶ A country's firms open more stores abroad than foreign firms open in the country.
- ▶ **A country sells more abroad than it purchases from abroad.**
- ▶ Foreign firms open more stores in a country than the country opens in foreign countries.

- ▶ A country purchases more from abroad than other countries purchase from it.

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Question No: 39 (Marks: 1) - Please choose one

A change from \$1.00 = Rs. 80.00 to \$1.00 = Rs. 85.00 represents:

- ▶ Depreciation of the dollar.
- ▶ An appreciation of the dollar.
- ▶ An appreciation of the rupee.
- ▶ **None of the given options.**

Question No: 40 (Marks: 1) - Please choose one

There is an increase in the economy's potential output when there is:

- ▶ An increase in government spending.
- ▶ A decrease in government spending.
- ▶ **An increase in the economy's capital stock.**
- ▶ An increase in the economy's depreciation rate.

Question No: 41 (Marks: 1) - Please choose one

One of the implications of Solow growth model is that all other things remaining the same, countries with rapidly growing population will tend to:

- ▶ **Be poorer than countries with lower population growth.**
- ▶ Grow slower than countries with lower population growth.
- ▶ Grow higher than countries with lower population growth.
- ▶ Have lower marginal products of capital than countries with lower population growth.

Question No: 42 (Marks: 1) - Please choose one

The rapid population growth in today's developing nations is due to the:

- ▶ High birth rates only.
- ▶ Low death rates only.
- ▶ **High birth rate and low death rate.**
- ▶ Higher standard of living.

Question No: 43 (Marks: 1) - Please choose one

The principle of taxation which emphasizes on fairness or just sacrifice is known as:

- ▶ Efficiency.
- ▶ **Equity.**
- ▶ Progressive tax.
- ▶ Regressive tax.

Question No: 44 (Marks: 1) - Please choose one

The relationship between tax rates and total tax collections by government is known as:

- ▶ **Laffer curve.**
- ▶ Demand curve.
- ▶ Supply curve.
- ▶ Investment curve.

Question No: 45 (Marks: 1) - Please choose one

The optimum tax rate in which government revenue is maximized lies somewhere between:

- ▶ 0% and 1%.
- ▶ **0% and 50%.**
- ▶ 50% and 100%.
- ▶ 0% and 100%.

Question No: 46 (Marks: 1) - Please choose one

Money is defined as an item that:

- ▶ **Serves as a medium of exchange for goods and services.**
- ▶ Can be converted into silver with relatively little loss in value.
- ▶ Can be converted into gold with relatively little loss in value.
- ▶ Facilitates a connecting link between credit instruments and debt instruments.

Question No: 47 (Marks: 1) - Please choose one

A tax imposed by a country on an imported good or service is called a:

- ▶ Quota.
- ▶ **Tariff.**
- ▶ Non-tariff barrier.
- ▶ Trade embargo.

Question No: 48 (Marks: 1) - Please choose one

Poor countries remained poor because of:

- ▶ Higher per capita income.
- ▶ **Vicious circle of poverty.**
- ▶ High level of investment.
- ▶ High rates of savings.

Question No: 49 (Marks: 1) - Please choose one

If other things remaining the same, expected income can be used as a direct measure of well-being in which of the following situations?

- ▶ It can be used if and only if individuals are not risk-loving.
- ▶ It can be used if and only if individuals are risk averse.
- ▶ It can be used if and only if individuals are risk neutral.
- ▶ **It can be used no matter what a person's preference to risk.**

Question No: 50 (Marks: 1) - Please choose one

What questions are related with explanation? What questions are related with what ought to be?

- ▶ Positive, negative.
- ▶ Negative, normative.
- ▶ Normative, positive.
- ▶ **Positive, normative.**

Question No: 51 (Marks: 1) - Please choose one

What will happen to the demand for product X, if there is an increase in consumer's income?

- ▶ It will necessarily remain unchanged.
- ▶ It will shift to the right if X is a complementary good.
- ▶ **It will shift to the right if X is a normal good.**
- ▶ It will shift to the right if X is an inferior good.

Question No: 52 (Marks: 1) - Please choose one

Which of the following occur when an isocost line is just tangent to an isoquant?

- ▶ **Output is being produced at minimum cost.**
- ▶ Output is not being produced at minimum cost.
- ▶ The two products are being produced at the medium input cost to the firm.
- ▶ The two products are being produced at the highest input cost to the firm.

Question No: 53 (Marks: 1) - Please choose one

Suppose all inputs are increased by 20% but output increases by less than 20% in a production process. This means that the firm experiences:

- ▶ **Decreasing returns to scale.**
- ▶ Constant returns to scale.
- ▶ Increasing returns to scale.
- ▶ None of the given options.

Question No: 54 (Marks: 1) - Please choose one

In which of the following conditions, a firm will never operate?

- ▶ At the minimum of its average total cost curve.
- ▶ **At the minimum of its average variable cost curve.**
- ▶ On the downward-sloping portion of its average total cost curve.
- ▶ On the downward-sloping portion of its average variable cost curve.

Question No: 55 (Marks: 3)

How the central bank plays its role in order to control the activities of commercial banks?

Question No: 56 (Marks: 5)

Briefly discuss different types of taxes which a government can impose.

Question No: 57 (Marks: 5)

A. Differentiate between final goods and intermediate goods with the help of examples.

B. See the following table:

Year	1979	1980	1981	1982	1983	1984	1985	1986
Real GDP Growth Rate	1.2%	-5.5%	1.8%	3.9%	4.5%	5.3%	2.6%	1.9%

- a) Calculate the average growth rate from 1982 and 1985.
- b) Calculate the average growth rate from 1979 and 1986.

(Marks: 3+2)

Question No: 58 (Marks: 10)

From the information given in the following table, calculate the number of unemployed persons and unemployment rate.

Year	Size of Labor Force	Number of persons Employed
1984	113544	105005
1985	115461	107150
1986	117834	109597
1987	119865	112440
1988	121669	114968

(Marks: 5+5)

Question No: 59 (Marks: 10)

Answer the following questions.

- a) What is interest parity condition?
- b) When does this condition hold?
- c) What is the equation of this condition?

d) What will happen if the equality of the condition does not hold?

(Marks: 2+2+2+4)

FINALTERM EXAMINATION (2)

Spring 2009

ECO401- Economics (Session - 2)

Question No: 1 (Marks: 1) - Please choose one

Aslam decides to stay at home and study for his exam rather than going out with his friends to a movie. His dilemma is an example of:

- ▶ The economic perspective.
- ▶ Marginal analysis.
- ▶ Allocative efficiency.
- ▶ **Opportunity cost.**

Question No: 2 (Marks: 1) - Please choose one

A good for which income and quantity demanded are inversely related is known as:

- ▶ **Inferior good.**
- ▶ Complementary good.
- ▶ Normal good.
- ▶ None of the given options.

Question No: 3 (Marks: 1) - Please choose one

An increase in supply is shown by:

- ▶ Shifting the supply curve to the left.
- ▶ **Shifting the supply curve to the right.**
- ▶ Upward movement along the supply curve.
- ▶ Downward movement along the supply curve.

Question No: 4 (Marks: 1) - Please choose one

Price floor results in:

- ▶ All of the given options.
- ▶ Excess supply.
- ▶ Equilibrium.
- ▶ **Excess demand.**

Question No: 5 (Marks: 1) - Please choose one

The price elasticity of demand measures the responsiveness of quantity demanded to:

- ▶ Quantity demanded.
- ▶ Quantity supplied.
- ▶ **Price.**
- ▶ Output.

Question No: 6 (Marks: 1) - Please choose one

Assume that the total utilities for the fifth and sixth units of a good consumed are 83 and 97, respectively. The marginal utility for the sixth unit is:

- ▶ -14.
- ▶ 14.
- ▶ 83.
- ▶ 97.

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Question No: 7 (Marks: 1) - Please choose one

Indifference curves that are convex to the origin reflect:

- ▶ An increasing marginal rate of substitution.
- ▶ **A decreasing marginal rate of substitution.**
- ▶ A constant marginal rate of substitution.
- ▶ A marginal rate of substitution that first decreases, then increases.

Question No: 8 (Marks: 1) - Please choose one

To find the profit maximizing level of output, a firm finds the output level where:

- ▶ Price equals marginal cost.
- ▶ Marginal revenue and average total cost.
- ▶ Price equals marginal revenue.
- ▶ **None of the given options.**

The profit maximizing level of output is found by equating its marginal revenue with its marginal cost, which is the same profit maximizing condition that a perfectly competitive firm uses to determine its equilibrium level of output. Indeed, the condition that marginal revenue equal marginal cost is used to determine the profit maximizing level of output of *every firm, regardless of the market structure in which the firm is operating.*

Question No: 9 (Marks: 1) - Please choose one

As compared to existing firms, a new firm entering in monopolist market has:

- ▶ **High costs.**
- ▶ Low costs.
- ▶ Equal costs.
- ▶ None of the given options.

Question No: 10 (Marks: 1) - Please choose one

A firm is charging a different price for each unit purchased by a consumer. This is called:

- ▶ First-degree price discrimination.
- ▶ Second-degree price discrimination.
- ▶ **Third-degree price discrimination.**
- ▶ None of the given options.

Question No: 11 (Marks: 1) - Please choose one

McDonald's restaurant located near the high school offered a Tuesday special for high school students. If high school students showed their student ID cards, they would be given 50 cents off any special meal. This practice is an example of:

- ▶ Collusion.
- ▶ Price discrimination.
- ▶ Two-part tariff.
- ▶ **Bundling.**

Question No: 12 (Marks: 1) - Please choose one

The price elasticity of demand for any good must be less than or equal to zero unless:

- ▶ The good is a necessity.
- ▶ The good is a luxury.
- ▶ **The good is a Giffen good.**
- ▶ None of the given options.

Question No: 13 (Marks: 1) - Please choose one

Figure

In figure given above, the marginal utility of income is:

- ▶ **Increasing as income increases.**
- ▶ Constant for all levels of income.
- ▶ Diminishes as income increases.
- ▶ None of the given options.

Question No: 14 (Marks: 1) - Please choose one

In monopoly, which of the following is NOT true?

- ▶ Products are differentiated.
- ▶ **There is freedom of entry and exit into the industry in the long run.**
- ▶ The firm is a price maker.
- ▶ There is one main seller.

Question No: 15 (Marks: 1) - Please choose one

Welfare economics is the branch of economics which deals with:

- ▶ Positive issues.
- ▶ **Normative issues.**
- ▶ Micro issues.
- ▶ Macro issues.

Question No: 16 (Marks: 1) - Please choose one

Under the kinked demand curve model, an increase in marginal cost will lead to:

- ▶ An increase in output level and a decrease in price.
- ▶ A decrease in output level and an increase in price.
- ▶ **A decrease in output level and no change in price.**
- ▶ Neither a change in output level nor a change in price.

Question No: 17 (Marks: 1) - Please choose one

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Which of the following market situation is much like a pure monopoly except that its member firms tend to cheat on agreed upon price and output strategies?

- ▶ Duopoly.
- ▶ **Cartel.**
- ▶ Market sharing monopoly.
- ▶ Natural monopoly.

Question No: 18 (Marks: 1) - Please choose one

In the complete classical model, a rightward shift of the labor supply curve will:

- ▶ Decrease the price level and increase the nominal wage.
- ▶ Decrease the nominal wage and increase the price level.
- ▶ Decrease both the price level and the nominal wage.
- ▶ **Increase both the price level and the nominal wage.**

Question No: 19 (Marks: 1) - Please choose one

Which of the following events could cause the aggregate demand curve to shift to the right?

- ▶ An increase in the rate of inflation.
- ▶ A decrease in government expenditures.
- ▶ A decrease in investment spending.
- ▶ **A decrease in income tax rates.**

Question No: 20 (Marks: 1) - Please choose one

The Great Depression of 1930s opened the door to the _____ revolution in macroeconomic theory.

- ▶ **Keynesian.**
- ▶ New classical.
- ▶ Old classical.
- ▶ New Keynesian.

Question No: 21 (Marks: 1) - Please choose one

Keynesian economics was the predominant economic theory:

- ▶ Prior to the late 1700s.
- ▶ From the late 1700s to the early 1900s.
- ▶ **From 1930s to 1970s.**
- ▶ Since 1970s.

Question No: 22 (Marks: 1) - Please choose one

Classical economics was replaced as the dominant theory of macroeconomic analysis by:

- ▶ Monetarism.
- ▶ Rational expectations.
- ▶ **Keynesian economics.**
- ▶ Neoclassical economics.

Question No: 23 (Marks: 1) - Please choose one

According to the model of aggregate supply and aggregate demand, in the long run, an increase in the money supply should cause:

- ▶ Both prices and output to rise.
- ▶ Prices to fall and output to remain unchanged.
- ▶ Both prices and output to fall.
- ▶ **Prices to rise and output to remain unchanged.**

Question No: 24 (Marks: 1) - Please choose one

Intermediate goods are meant for:

- ▶ Direct use by the consumers.
- ▶ **Further processing.**
- ▶ The term do not exist.
- ▶ None of the given options.

Question No: 25 (Marks: 1) - Please choose one

Final goods are meant for:

- ▶ **Direct use by the consumers.**
- ▶ Further processing.
- ▶ The term do not exist.
- ▶ None of the given options.

Question No: 26 (Marks: 1) - Please choose one

Which of the following is a flow variable?

- ▶ The value of the house in which you live.
- ▶ **The balance in your savings account.**
- ▶ Your monthly consumption on food items.
- ▶ The number of carrots in your refrigerator at the beginning of the month.

Question No: 27 (Marks: 1) - Please choose one

Which of the following is NOT a stock variable?

- ▶ Government debt.
- ▶ Capital.
- ▶ **The amount of money held by the public.**
- ▶ Inventory investment.

Question No: 28 (Marks: 1) - Please choose one

All other things remain the same, Gross Domestic Product (GDP) will rise if:

- ▶ Imports rises.
- ▶ Exports falls.
- ▶ **Durable goods consumption rises.**
- ▶ Military spending falls.

Question No: 29 (Marks: 1) - Please choose one

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If disposable income increases from \$5 trillion to \$6 trillion and as a result, consumption expenditure increases from \$7 trillion to \$7.8 trillion, the Marginal Propensity to Consume is:

- ▶ 1.0.
- ▶ **0.8.**
- ▶ $5/7 = 0.71$.
- ▶ $6/7.8 = 0.77$.

Question No: 30 (Marks: 1) - Please choose one
The slope of the consumption function (or line) is the:

- ▶ Average propensity to save.
- ▶ Average propensity to consume.
- ▶ Marginal propensity to save.
- ▶ **Marginal propensity to consume.**

Question No: 31 (Marks: 1) - Please choose one
Suppose that your income increases from \$100,000 to \$150,000 and your consumption increases from \$80,000 to \$120,000. Your Marginal Propensity to Save (MPS) is:

- ▶ 0.2.
- ▶ 0.4.
- ▶ 0.6.
- ▶ **0.8.**

Question No: 32 (Marks: 1) - Please choose one
The unemployment rate is equal to:

- ▶ Number of employed / labour force x 100.
- ▶ **Number of unemployed / labour force.**
- ▶ (Number of unemployed / labour force) x 100.
- ▶ None of the given options.

Question No: 33 (Marks: 1) - Please choose one
The traditional Phillips Curve shows the:

- ▶ **Inverse relationship between the rate of inflation and unemployment rate.**
- ▶ Inverse relationship between the nominal and real wage.
- ▶ Direct relationship between unemployment and demand-pull inflation.
- ▶ Tradeoff between the short run and long run.

Question No: 34 (Marks: 1) - Please choose one
Deflation is:

- ▶ An increase in the overall level of economic activity.
- ▶ An increase in the overall price level.
- ▶ A decrease in the overall level of economic activity.
- ▶ **A decrease in the overall price level.**

Question No: 35 (Marks: 1) - Please choose one

Is Gross Domestic Product (GDP) an accurate measure of a country's well being?

- ▶ Yes, it is the best measure of national well being.
- ▶ **Yes, provided we use real GDP and not nominal GDP.**
- ▶ Uncertain, depending on whether GDP is rising or falling.
- ▶ No, it is not.

Question No: 36 (Marks: 1) - Please choose one

Real Gross Domestic Product (GDP):

- ▶ **Is nominal GDP adjusted for changes in the price level.**
- ▶ Is also called nominal GDP.
- ▶ Measures GDP minus depreciation of capital.
- ▶ Will always change when prices change.

Question No: 37 (Marks: 1) - Please choose one

If a war destroys a large portion of a country's capital stock but the saving rate is unchanged, the exogenous model predicts that output will grow and the new steady state will approach:

- ▶ A higher output level than before.
- ▶ The same output level as before.
- ▶ **A lower output level than before.**
- ▶ The Golden Rule output level.

Question No: 38 (Marks: 1) - Please choose one

A currency appreciation:

- ▶ **Reduces aggregate demand and increases aggregate supply.**
- ▶ Reduces both aggregate demand and aggregate supply.
- ▶ Increases aggregate demand and reduces aggregate supply.
- ▶ Increases both aggregate demand and aggregate supply.

Question No: 39 (Marks: 1) - Please choose one

M1 component of money supply consists of:

- ▶ Paper currency and coins.
- ▶ **Paper currency, coins and check writing deposits.**
- ▶ Paper currency, coins, check writing deposits and savings deposits.
- ▶ Paper currency, coins, check writing deposits, savings deposits and certificates of deposits.

Question No: 40 (Marks: 1) - Please choose one

Personal income:

- ▶ Is income received by individuals during a given year.
- ▶ Is the income individuals have available for spending during a given year.
- ▶ Equals national income minus indirect taxes.

- ▶ **Is the sum of wages plus interest received by individuals during a given year.**

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Question No: 41 (Marks: 1) - Please choose one

Real Gross National Product (GNP) is best defined as:

- ▶ The pound value of all final goods and services produced in the economy during a particular time period and measured in current prices.
- ▶ The pound value of all goods produced for final consumption by households in a particular year and measured in constant prices.
- ▶ The current pound value of all new and used goods produced and sold in the economy during a particular time period.
- ▶ **The market value of all final goods and services produced by the economy during a given time period, with prices held constant relative to some base period.**

Question No: 42 (Marks: 1) - Please choose one

Which of the following statements describes the difference between nominal and real Gross Domestic Product (GDP)?

- ▶ Real GDP includes only goods; nominal GDP includes goods and services.
- ▶ **Real GDP is measured using constant base-year prices; nominal GDP is measured using current prices.**
- ▶ Real GDP is equal to nominal GDP less the depreciation of the capital stock.
- ▶ Real GDP is equal to nominal GDP multiplied by the CPI.

Question No: 43 (Marks: 1) - Please choose one

If we compare Gross Domestic Product (GDP) with Gross National Product (GNP) then:

- ▶ $GNP = GDP - \text{Net income from abroad.}$
- ▶ **$GNP = GDP + \text{Net income from abroad.}$**
- ▶ $GNP = NNP - \text{Net income from abroad.}$
- ▶ $GNP = NNP + \text{Net income from abroad.}$

Question No: 44 (Marks: 1) - Please choose one

Gross domestic product (GDP) is the market value of:

- ▶ All transactions in an economy during one-year period.
- ▶ All goods and services exchanged in an economy during one-year period.
- ▶ All final goods and services exchanged in an economy during one-year period.
- ▶ **All final goods and services produced in a domestic economy during one-year period.**

Question No: 45 (Marks: 1) - Please choose one

Which of the following shows the Fisher equation of exchange?

- ▶ $MT = PV.$
- ▶ $VT = PM.$
- ▶ **$MV = PQ.$**
- ▶ $MY = VP.$

Question No: 46 (Marks: 1) - Please choose one

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An exchange rate that varies according to the supply and demand for the currency in the foreign exchange market is called:

- ▶ Overvalued exchange rate.
- ▶ Undervalued exchange rate.
- ▶ Fixed exchange rate.
- ▶ **Flexible exchange rate.**

Question No: 47 (Marks: 1) - Please choose one

In the equation $MV = PQ$, according to the crude quantity theory of money:

- ▶ M has no effect on the price level.
- ▶ **V is the number of times each dollar is spent per year.**
- ▶ Q is the real price level.
- ▶ P rises as V falls, other things constant.

Question No: 48 (Marks: 1) - Please choose one

In the Keynesian cross model, the 45-degree line has a slope of:

- ▶ 45.
- ▶ Infinity.
- ▶ **1.**
- ▶ 0.

Question No: 49 (Marks: 1) - Please choose one

In Keynesian economics, equilibrium can occur:

- ▶ Only at full employment level.
- ▶ Only at levels less than full employment.
- ▶ Only at levels greater than full employment.
- ▶ **At any level of aggregate output which is equal to aggregate expenditures.**

Question No: 50 (Marks: 1) - Please choose one

After a decrease in the wage, the substitution effect implies that:

- ▶ Only the amount demanded of capital decreases.
- ▶ Only the amount demanded of labor decreases.
- ▶ **Only the amount demanded of capital increases.**
- ▶ The amount demanded of all inputs increases.

Question No: 51 (Marks: 5)

Briefly discuss the private cost of advertising. How we can calculate the marginal social cost?

ANSWER: Private Cost Of Advertising: The private cost of advertising is the cost incurred by firm in making the advertisement i.e newspaper adds, tv commercials etc. The firms do not take into account the nuisance faced by people due to these advertisements otherwise the firms would do less advertisement.

Marginal Social Cost: Marginal social cost is not a monetary based cost. It is the cost borne by the society as a whole. It is the cost of consumption of one next unit.

Question No: 52 (Marks: 10)

A. What conclusions are derived from exogenous growth theory?

ANSWER: Exogenous Growth Theory: The major conclusions derived from the exogenous growth are as follows:

- The steady growth rate of real GDP depends on exogenous rates of growth of population (n) and technology (t). There are no policies for government for how to affect the steady growth rate of a country. Higher savings can only have a little effect on income it cannot cause long term growth because savings cause diminishing returns to investment and capital accumulation.
- If one country started with lower income and capital than another country, the poorer country will grow faster to catch up the richer country and then both the countries will grow together.

B. What is meant by convergence theory? Explain the convergence theory in the given graph.

(Marks: 4+6)

Question No: 53 (Marks: 10)

Define fiscal policy. Differentiate between contractionary and expansionary fiscal policy. In which situations, budget deficit and budget surplus exist?

Answer: Fiscal Policy: Fiscal policy is the government's about the

- expenditure in form of purchases, subsidies and interest payments on debt etc.
- revenue in form of taxes etc.

Difference between Contractionary and Expansionary Fiscal Policy:

Conactionary Fiscal Policy	Expansionary Fiscal Policy
In conactionary fiscal policy government decreases its expenditure.	In expansionary fiscal policy government increases its expenditure.

Budget Deficit and Budget Surplus: Budget deficit exists if government expenditure increases the revenue earned. In this case government needs to finance its expenditure through borrowing.

Budget surplus exists when revenue exceeds the government expenditure. In this condition government can easily pay off its debt borrowings.

(Marks: 2+4+4)

Question No: 54 (Marks: 10)

Discuss the basic theories regarding IMF's stabilization program. Are these

theories successful? If not, give reasons.

Answer: IMF's Stabilization Theories:

- Tight Fiscal Policy:** It works through higher revenues and reduced government expenditure.
- Devaluation:** Switching from imports to home produced goods. It increases competitiveness, exports and increase investors confidence in local currency.
- Tight Monetary Policy:** Higher interest rates resulting in reduced private sector consumption and investment demand. It reduces inflation and increases savings. High interest rates also results in higher capital inflow.

These theories are generally not successful in lower income countries (LICs). Because they caused the problems of:

- **Devaluation:** It raises the price of imports and also increased the inflation while the real wage rate could not increase.
- **Stabilization hurts poor:** decrease in expenditure always badly effects the poor which can then cause political instability.

FINAL TERM EXAMINATION (3)
Spring 2009
ECO401- Economics (Session - 2)

Question No: 1 (Marks: 1) - Please choose one

In a free-market economy, the allocation of resources is determined by:

- ▶ Votes taken by consumers.
- ▶ A central planning authority.
- ▶ **Consumer preferences.**
- ▶ The level of profits of firms.

Question No: 2 (Marks: 1) - Please choose one

The concave shape of the production possibilities curve for two goods X and Y illustrates:

- ▶ **Increasing opportunity cost for both goods.**
- ▶ Increasing opportunity cost for good X but not for good Y.
- ▶ Increasing opportunity cost for good Y but not for good X.
- ▶ Constant opportunity cost for both goods.

Question No: 3 (Marks: 1) - Please choose one

If the quantity demanded of a product is greater than the quantity supplied of a product, then:

- ▶ There is a shortage of the product.
- ▶ **There is a surplus of the product.**
- ▶ The product is a normal good.
- ▶ The product is an inferior good.

Question No: 4 (Marks: 1) - Please choose one

The supply curve is upward-sloping because:

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- ▶ As the price increases, consumers demand less.
- ▶ **As the price increases, suppliers can earn higher levels of profit or justify higher marginal costs to produce more.**
- ▶ None of the given options.
- ▶ As the price increases, so do costs.

Question No: 5 (Marks: 1) - Please choose one

When an industry's raw material costs increase, other things remaining the same:

- ▶ **The supply curve shifts to the right.**
- ▶ Output increases regardless of the market price and the supply curve shifts upward.
- ▶ Output decreases and the market price also decrease.
- ▶ The supply curve shifts to the left.

Question No: 6 (Marks: 1) - Please choose one

When the price of petrol rises by 12%, the quantity of petrol purchased falls by 8%. This shows that the demand for petrol is:

solution= $Ped = \% \text{ change in } Q \text{ demand} / \% \text{ change in } Q \text{ Price} = 10\%/12\% = 0.5$ where
 $e > 1$ elastic
 $e < 1$ inelastic

- ▶ Perfectly elastic.
- ▶ Unit elastic.
- ▶ Elastic.
- ▶ Inelastic.

Question No: 7 (Marks: 1) - Please choose one

Suppose price rises from \$15 to \$17 and quantity demanded decreases by 20%. We can conclude:

- ▶ Demand is unitary elastic.
- ▶ Demand is elastic.
- ▶ The elasticity of demand is 2.
- ▶ **Total revenue will decrease.**

Question No: 8 (Marks: 1) - Please choose one

"Utility" is most closely related to the term:

- ▶ Useless.
- ▶ Require.
- ▶ Necessary.
- ▶ **Satisfaction.**

Question No: 9 (Marks: 1) - Please choose one

When the marginal utility of a good is zero, this implies that:

- ▶ **The consumer would not spend any additional income to buy more of that good.**

- ▶ Consumption of additional units would have positive marginal utility.
- ▶ Total utility is minimized.
- ▶ Total utility is also zero.

Question No: 10 (Marks: 1) - Please choose one

When the substitution effect of a lowered price is counteracted by the income effect, the good in question is:

- ▶ **An inferior good.**
- ▶ A substitute good.
- ▶ An independent good.
- ▶ A normal good.

Question No: 11 (Marks: 1) - Please choose one

Diminishing marginal returns implies:

- ▶ Decreasing marginal costs.
- ▶ **Increasing marginal costs.**
- ▶ Decreasing average variable costs.
- ▶ Decreasing average fixed costs.

Question No: 12 (Marks: 1) - Please choose one

A graph showing all the combinations of capital and labour available for a given total cost is the:

- ▶ Budget constraint.
- ▶ Expenditure set.
- ▶ Isoquant.
- ▶ **Isocost.**

Question No: 13 (Marks: 1) - Please choose one

When an isocost line is just tangent to an isoquant, we know that:

- ▶ Output is being produced at minimum cost.
- ▶ Output is not being produced at minimum cost.
- ▶ The two products are being produced at the medium input cost to the firm.
- ▶ The two products are being produced at the highest input cost to the firm.

Question No: 14 (Marks: 1) - Please choose one

In order for a taxicab to be operated in New York City, it must have a medallion on its hood. Medallions are expensive but can be resold and are therefore an example of: mid question

- ▶ **A fixed cost.**
- ▶ A variable cost.
- ▶ An implicit cost.
- ▶ An opportunity cost.

Question No: 15 (Marks: 1) - Please choose one

The good produced by a monopoly:

- ▶ Has perfect substitutes.
- ▶ Has no substitutes at all.

- ▶ **Has no close substitutes.**
- ▶ Can be easily duplicated.

Question No: 16 (Marks: 1) - Please choose one
Welfare economics is the branch of economics which deals with:

- ▶ Positive issues.
- ▶ **Normative issues.**
- ▶ Micro issues.
- ▶ Macro issues.

Question No: 17 (Marks: 1) - Please choose one
The oligopoly model which predicts that oligopoly prices will tend to be very rigid is the:

- ▶ Cournot model.
- ▶ Cobweb model.
- ▶ Dominant firm model.
- ▶ **Kinked demand model.**

Question No: 18 (Marks: 1) - Please choose one
The kinked demand curve model is based on which of the following assumptions?

- ▶ Each firm considers its rival's output to be fixed.
- ▶ Each firm considers its rival's price to be fixed.
- ▶ Each firm believes rival will match all price changes.
- ▶ None of the given options.

Question No: 19 (Marks: 1) - Please choose one
Which of the following is NOT conducive to the successful operation of a cartel?

- ▶ Market demand for the good is relatively inelastic.
- ▶ The cartel supplies all of the world's output of the good.
- ▶ Cartel members have substantial cost advantages over non-member producers.
- ▶ The supply of non-cartel members is very price elastic.

Question No: 20 (Marks: 1) - Please choose one
Cartels are:

- ▶ **Organizations of independent firms, producing similar products, that work together to raise prices and restrict output.**
- ▶ Organizations of interdependent firms, producing similar products, that work together to raise prices and restrict output.
- ▶ Organizations of independent firms, producing different products, that work together to raise prices and restrict output.
- ▶ Considered as part of monopolistic competition.

Question No: 21 (Marks: 1) - Please choose one
The marginal revenue product is:

- ▶ Upward sloping due to the law of demand.
- ▶ Upward sloping due to the law of marginal utility.

▶ **Downward sloping due to the law of diminishing returns.**

▶ Downward sloping due to the law of supply.

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Question No: 22 (Marks: 1) - Please choose one

A reason why some economists basically ignore the short run is because they believe that the economy:

▶ Has self-correcting mechanisms.

▶ Can only be graphed with a horizontal curve.

▶ Never needs correction.

▶ None of the given options.

Question No: 23 (Marks: 1) - Please choose one

The long run aggregate supply curve will shift to the right if:

▶ The price level increases.

▶ **Factors of production (such as labor and capital) increase.**

▶ Expenditures (such as consumption and net exports) increase.

▶ The prices of inputs used to produce goods and services (such as wages and the price of oil) decrease.

Question No: 24 (Marks: 1) - Please choose one

A primary implication of Keynesian economics is:

▶ The best government is the least government.

▶ **Flexible wages and prices ensure full employment.**

▶ Monetary policy is far superior to fiscal policy.

▶ Business-cycle instability is best corrected through government policies.

Question No: 25 (Marks: 1) - Please choose one

The economic analysis most closely related to Say's Law is:

▶ Short-run aggregate market.

▶ Production possibilities.

▶ Imperfect competition.

▶ Circular flow.

Question No: 26 (Marks: 1) - Please choose one

Which of the following is NOT a reason of downward slope of aggregate demand curve?

▶ The exchange-rate effect.

▶ The wealth effect.

▶ **The classical dichotomy / monetary neutrality effects.**

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- ▶ The interest-rate effect.

Question No: 27 (Marks: 1) - Please choose one
The upward-sloping aggregate supply curve indicates that:

- ▶ As firms increase their level of output, the cost of producing an extra unit increases.
- ▶ An increase in aggregate demand causes little, if any increase in real output the economy is operating in the long run.
- ▶ Any increase in aggregate demand causes the output of producers to fall because the general price level rises.
- ▶ None of the given options.

Question No: 28 (Marks: 1) - Please choose one
An important difference between the Classical and Keynesian approaches to achieve a macroeconomic equilibrium is that:

- ▶ **Keynesian economists actively promote the use of fiscal policy while the classical economists do not.**
- ▶ Keynesian economists actively promote the use of monetary policy to improve aggregate economic performance while the classical economists do not.
- ▶ Classical economists believe that monetary policy will certainly affect the level of output while the Keynesians believe that money growth affects only prices.
- ▶ Classical economists believe that fiscal policy is an effective tool for achieving economic stability while the Keynesians do not.

Question No: 29 (Marks: 1) - Please choose one
According to classical economists, the:

- ▶ **Aggregate demand curve is downward sloping and the aggregate supply curve is vertical.**
- ▶ Aggregate demand curve is downward sloping and the aggregate supply curve is upward sloping.
- ▶ Aggregate demand curve is vertical and the aggregate supply curve is upward sloping.
- ▶ Aggregate demand curve is vertical and the aggregate supply curve is horizontal.

Question No: 30 (Marks: 1) - Please choose one
How many methods are there to measure Gross Domestic Product?

- ▶ Three.
- ▶ Four.
- ▶ Five.
- ▶ Six.

Question No: 31 (Marks: 1) - Please choose one
Which of the following is a flow variable?

- ▶ The value of the house in which you live.
- ▶ The balance in your savings account.
- ▶ **Your monthly consumption on food items.**

- ▶ The number of carrots in your refrigerator at the beginning of the month.

Question No: 32 (Marks: 1) - Please choose one
Which of the following is NOT a stock variable?

- ▶ Government debt.
- ▶ **Capital.**
- ▶ The amount of money held by the public.
- ▶ Inventory investment.

Question No: 33 (Marks: 1) - Please choose one

Suppose that your income increases from \$100,000 to \$150,000 and your consumption increases from \$80,000 to \$120,000. Your Marginal Propensity to Save (MPS) is:

delta consumption/ delta income =40/50=.8

- ▶ 0.2.
- ▶ 0.4.
- ▶ 0.6.
- ▶ **0.8.**

Question No: 34 (Marks: 1) - Please choose one

Which of the following plays the key balancing role in making sure that the economy reaches and stays at equilibrium at the potential output level?

- ▶ Real exchange rate.
- ▶ The production function.
- ▶ Real price level.
- ▶ Real interest rate.

Question No: 35 (Marks: 1) - Please choose one

If injections are less than withdrawals at the full-employment level of income then there arises:

- ▶ A deflationary gap.
- ▶ Hysteresis.
- ▶ Hyperinflation.
- ▶ An inflationary gap.

Question No: 36 (Marks: 1) - Please choose one

The labour force is made up of:

- ▶ The number of people employed minus the number of people unemployed.
- ▶ The number of people employed plus the number of people unemployed.
- ▶ Just the number of people employed.
- ▶ The whole population.

Question No: 37 (Marks: 1) - Please choose one

Deflation is:

- ▶ An increase in the overall level of economic activity.
- ▶ An increase in the overall price level.
- ▶ A decrease in the overall level of economic activity.
- ▶ **A decrease in the overall price level.**

Question No: 38 (Marks: 1) - Please choose one

Which of the following will result if there is a decrease in aggregate demand?

- ▶ Expansion; inflation.
- ▶ Recession; deflation.
- ▶ Expansion; deflation.
- ▶ Recession; inflation.

Question No: 39 (Marks: 1) - Please choose one

A decrease in the natural rate of unemployment will:

- ▶ Shift the Phillips curve to the left.
- ▶ Result in a decrease in the inflation rate along the Phillips curve.
- ▶ **Shift the Phillips curve to the right.**
- ▶ Result in an increase in the inflation rate along the Phillips curve.

Question No: 40 (Marks: 1) - Please choose one

The Phillips curve will shift to the right:

- ▶ If there is a decrease in the expected inflation rate.
- ▶ If there is an increase in the expected inflation rate.
- ▶ If there is a decrease in the natural rate of unemployment.
- ▶ **If there is a favorable supply shock.**

Question No: 41 (Marks: 1) - Please choose one

If a country has flexible exchange rate and has more rapid inflation rate than other countries, its currency will:

- ▶ Appreciate.
- ▶ **Depreciate.**
- ▶ Not effect.
- ▶ All of the given are possible.

Question No: 42 (Marks: 1) - Please choose one

The nominal exchange rate is defined as the:

- ▶ Market on which currencies of various nations are traded for one another.
- ▶ Price of one unit of foreign good in terms of domestic good.
- ▶ **Price of one unit of foreign currency in terms of domestic currency.**
- ▶ All of the given options.

Question No: 43 (Marks: 1) - Please choose one

Current account deficit is equal to:

- ▶ Private sector resource deficit.
- ▶ Government budget deficit.
- ▶ Private sector resource deficit + Government budget deficit.

- ▶ None of the given options.

Question No: 44 (Marks: 1) - Please choose one

In the exogenous growth model, if investment exceeds depreciation, the capital stock will ----- and output will----- until the steady state is attained.

- ▶ **Increase; increase.**
- ▶ Increase; decrease.
- ▶ Decrease; decrease.
- ▶ Decrease; increase.

Question No: 45 (Marks: 1) - Please choose one

Endogenous growth theory differs in what essential aspect from the Solow theory of economic growth?

- ▶ Endogenous growth theory is a monetary theory whereas the Solow theory is a real theory.
- ▶ Endogenous growth theory assumes diminishing returns to capital and the Solow theory assumes constant returns.
- ▶ **In endogenous growth theory, economies with the same technology and saving rate need not converge to the same steady state as in the Solow model.**
- ▶ All of the given options are correct.

Question No: 46 (Marks: 1) - Please choose one

A currency appreciation should:

- ▶ Reduce net exports and therefore increase aggregate demand.
- ▶ Raise net exports and therefore decrease aggregate demand.
- ▶ Reduce net exports and therefore decrease aggregate demand.
- ▶ Raise net exports and therefore increase aggregate demand.

Question No: 47 (Marks: 1) - Please choose one

M1 component of money supply consists of:

- ▶ Paper currency and coins.
- ▶ **Paper currency, coins and check writing deposits.**
- ▶ Paper currency, coins, check writing deposits and savings deposits.
- ▶ Paper currency, coins, check writing deposits, savings deposits and certificates of deposits.

Question No: 48 (Marks: 1) - Please choose one

Commercial banks in Pakistan are supervised by:

- ▶ **State bank.**
- ▶ National bank.
- ▶ Finance minister.
- ▶ World bank.

Question No: 49 (Marks: 1) - Please choose one

What would result from a depreciation of the pound on the foreign exchange

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market?

- ▶ An increase in the price of imported computers.
- ▶ A fall in the purchasing power of US tourists in London.
- ▶ A fall in the price of imported computers.
- ▶ An increase in the purchasing power of UK tourists overseas.

Question No: 50 (Marks: 1) - Please choose one

An example of hysteresis having a negative effect on a country's economy would be:

- ▶ Hyperinflation caused by excessive demand.
- ▶ Nervous investors selling all their shares, causing the stockmarket to crash.
- ▶ **Unemployed workers not taking available jobs.**
- ▶ Women being kept out of jobs traditionally held by men.

Question No: 51 (Marks: 5)

Briefly discuss the concept of comparative advantage with the help of example.

Question No: 52 (Marks: 10)

A. Differentiate between Marginal Propensity to Consume (MPC) and Marginal Propensity to Save (MPS).

B. Suppose a household has the consumption function (C) presented in the figure given below:

- a. Find consumption when disposable income is \$8,000 and \$10,000.
- b. Find consumption when disposable income is \$ 6,000. How can a household consume more than its disposable income?
- c. What is true for every point on the 45° line?

(Marks: 4+6)

Question No: 53 (Marks: 10)

Define M0 and M1. Briefly discuss the three broad motives of holding money.

(Marks:4+6)

Question No: 54 (Marks: 10)

Recall the Equation of Quantity theory of money and calculate the missing figure in each of the following cases:

- a) Money supply (M) =100, Price (P) = 3 and real output (Q) = 200. Calculate the missing figure.
- b) Velocity of money (V) = 4, Price (P) = 5 and output (Q) =100. Calculate the missing figure.
- c) Money supply (M) = 200, velocity of money (V) = 7 and output (Q) = 700. Calculate the missing figure.
- d) Money supply (M) =150, velocity of money (V) = 8, Price level (P) = 3. Calculate the missing value.

(Marks: 2.5 each)

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FINALTERM EXAMINATION (4)
Fall 2008
ECO401- Economics (Session - 3)

Time: 120 min
Marks: 85

Question No: 1 (Marks: 1) - Please choose one

To calculate the price elasticity of demand, you need to know _____ point(s) on the _____ demand curve.

- ▶ One, same.
- ▶ Two, same.
- ▶ One, opposite.
- ▶ Two, **opposite**.

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Question No: 2 (Marks: 1) - Please choose one

Governments protect domestic industries from foreign competition by _____.

- ▶ **Encouraging agreements like NAFTA.**
- ▶ Using tariff and non tariff barriers.
- ▶ Discouraging union membership.
- ▶ Keeping the minimum wage low.

Question No: 3 (Marks: 1) - Please choose one

To make the equation of exchange in the quantity theory of money:

- ▶ V and Q are assumed to be constant.
- ▶ The money supply is assumed to be produced by the banking system and not exclusively in currency.
- ▶ The quantity of money is assumed to determine the amount of Real GDP.
- ▶ **M and P are considered constant.**

Question No: 4 (Marks: 1) - Please choose one

In the equation $MV = PQ$, according to the crude quantity theory of money:

- ▶ M has no effect on the price level.
- ▶ **V is the number of times each dollar is spent per year.**
- ▶ Q is the real price level.
- ▶ P rises as V falls, other things constant.

Question No: 5 (Marks: 1) - Please choose one

What would result from a depreciation of the pound on the foreign exchange market?

- ▶ **An increase in the price of imported computers.**
- ▶ A fall in the purchasing power of US tourists in London.
- ▶ A fall in the price of imported computers.
- ▶ An increase in the purchasing power of UK tourists overseas.

Question No: 6 (Marks: 1) - Please choose one

Disposable income is:

- ▶ Total income plus transfer payments.
- ▶ Total income minus saving.

- ▶ Total income plus net taxes.
- ▶ **Total income minus net taxes.**

Question No: 7 (Marks: 1) - Please choose one

How should monetary policy be used during recessions?

- ▶ Decrease money supply to increase interest rate and increase aggregate demand.
- ▶ Increase money supply to increase interest rate and increase aggregate demand.
- ▶ **Decrease money supply to decrease interest rate and increase aggregate demand.**
- ▶ Increase money supply to decrease interest rate and increase aggregate demand.

Question No: 8 (Marks: 1) - Please choose one

Which of the following policy options would simultaneously increase interest rates and decrease output?

- ▶ **The central bank sells bonds through open market operations.**
- ▶ The federal government increases its defense purchases.
- ▶ The central bank expands the money supply.
- ▶ The federal government increases the tax rate.

Question No: 9 (Marks: 1) - Please choose one

An increase in the money supply will cause interest rates to:

- ▶ **Rise.**
- ▶ Fall.
- ▶ Remain unchanged.
- ▶ None of the given options.

Question No: 10 (Marks: 1) - Please choose one

Commercial banks in Pakistan are supervised by:

- ▶ State bank.
- ▶ National bank.
- ▶ Finance minister.
- ▶ World bank.

Question No: 11 (Marks: 1) - Please choose one

Fiscal policy is the government program with respect to its:

- ▶ **Expenditure and tax revenue.**
- ▶ Increase in unemployment.
- ▶ Steel Mill Privatization.
- ▶ Unemployment reduction.

Question No: 12 (Marks: 1) - Please choose one

An expansionary fiscal policy can:

- ▶ Raise the national debt.
- ▶ **Decrease the national debt.**
- ▶ Have no effect on national debt.
- ▶ None of the given options.

Question No: 13 (Marks: 1) - Please choose one

If a war destroys a large portion of a country's capital stock but the saving rate is unchanged, the exogenous model predicts that output will grow and the new steady state will approach:

- ▶ A higher output level than before.
- ▶ The same output level as before.
- ▶ A lower output level than before.
- ▶ **The Golden Rule output level.**

Question No: 14 (Marks: 1) - Please choose one

If the prices of all goods and services rise during the year:

- ▶ Real GDP may fall.
- ▶ Nominal GDP must fall.
- ▶ Nominal GDP may increase.
- ▶ **Real GDP must rise.**

Question No: 15 (Marks: 1) - Please choose one

Is Gross Domestic Product (GDP) an accurate measure of a country's well being?

- ▶ Yes, it is the best measure of national well being.
- ▶ Yes, provided we use real GDP and not nominal GDP.
- ▶ **Uncertain, depending on whether GDP is rising or falling.**
- ▶ No, it is not.

Question No: 16 (Marks: 1) - Please choose one

Economic activity moves from a trough into a period of ----- until it reaches a ----- and then into a period of -----.

- ▶ Expansion; trough; recession
- ▶ Recession; trough; expansion
- ▶ **Expansion; peak; recession**
- ▶ Recession; peak; expansion

Question No: 17 (Marks: 1) - Please choose one

The Phillips curve will shift to the right:

- ▶ If there is a decrease in the expected inflation rate.
- ▶ If there is an increase in the expected inflation rate.
- ▶ If there is a decrease in the natural rate of unemployment.
- ▶ **If there is a favorable supply shock.**

Question No: 18 (Marks: 1) - Please choose one

A decrease in the natural rate of unemployment will:

- ▶ Shift the Phillips curve to the left.

- ▶ Result in a decrease in the inflation rate along the Phillips curve.
- ▶ **Shift the Phillips curve to the right.**
- ▶ Result in an increase in the inflation rate along the Phillips curve.

Question No: 19 (Marks: 1) - Please choose one

The unemployment rate is equal to:

- ▶ Number of employed / labour force x 100.
- ▶ Number of unemployed / labour force.
- ▶ **(Number of unemployed / labour force) x 100.**
- ▶ None of the given options.

Question No: 20 (Marks: 1) - Please choose one

Suppose that your income increases from \$100,000 to \$150,000 and your consumption increases from \$80,000 to \$120,000. Your Marginal Propensity to Save (MPS) is:

- ▶ 0.2.
- ▶ 0.4.
- ▶ 0.6.
- ▶ **0.8.**

Question No: 21 (Marks: 1) - Please choose one

Which of the following is NOT a stock variable?

- ▶ Government debt.
- ▶ **Capital.**
- ▶ The amount of money held by the public.
- ▶ Inventory investment.

Question No: 22 (Marks: 1) - Please choose one

Which of the following is a flow variable?

- ▶ The value of the house in which you live.
- ▶ The balance in your savings account.
- ▶ **Your monthly consumption on food items.**
- ▶ The number of carrots in your refrigerator at the beginning of the month.

Question No: 23 (Marks: 1) - Please choose one

Real Gross Domestic Product (GDP) is measured:

- ▶ At base year prices.
- ▶ At current year prices.
- ▶ At a constant output level but at current prices.
- ▶ **As the difference between the current year's GDP and last year's GDP.**

Question No: 24 (Marks: 1) - Please choose one

According to the model of aggregate supply and aggregate demand, in the long run, an increase in the money supply should cause:

- ▶ Both prices and output to rise.
- ▶ Prices to fall and output to remain unchanged.
- ▶ Both prices and output to fall.
- ▶ **Prices to rise and output to remain unchanged.**

Question No: 25 (Marks: 1) - Please choose one

According to classical economics, the economy was unlikely to experience:

- ▶ **Full employment.**
- ▶ Flexible wages and prices.
- ▶ Equality between saving and investment.
- ▶ High rates of unemployment.

Question No: 26 (Marks: 1) - Please choose one

A primary implication of Keynesian economics is:

- ▶ The best government is the least government.
- ▶ **Flexible wages and prices ensure full employment.**
- ▶ Monetary policy is far superior to fiscal policy.
- ▶ Business-cycle instability is best corrected through government policies.

Question No: 27 (Marks: 1) - Please choose one

Keynesian economics was the predominant economic theory:

- ▶ Prior to the late 1700s.
- ▶ From the late 1700s to the early 1900s.
- ▶ From 1930s to 1970s.
- ▶ **Since 1970s.**

Question No: 28 (Marks: 1) - Please choose one

According to Keynes, the economy does not self correct quickly because:

- ▶ With less consumption and more savings the interest rate will drop.
- ▶ In the short run workers are fully employed and cannot produce enough to get to long run equilibrium.
 - ▶ Wages and prices are flexible in the short run.
 - ▶ **Wages and prices are sticky in the short run.**

Question No: 29 (Marks: 1) - Please choose one

Which of the following will lead to an increase in aggregate demand?

- ▶ An increase in government tax revenues.
- ▶ An increase in household savings.
- ▶ **An increase in business capital investment.**
- ▶ An increase in demand for imports.

Question No: 30 (Marks: 1) - Please choose one

The aggregate supply curve is the relationship between:

- ▶ The price level and the real domestic output purchased.
- ▶ **The price level and the real domestic output produced.**
- ▶ The price level which producers are willing to accept and the price level purchasers are willing to pay.
- ▶ The real domestic output purchased and the real domestic output produced.

Question No: 31 (Marks: 1) - Please choose one

The marginal revenue product is:

- ▶ Upward sloping due to the law of demand.
- ▶ Upward sloping due to the law of marginal utility.
- ▶ **Downward sloping due to the law of diminishing returns.**
- ▶ Downward sloping due to the law of supply.

Question No: 32 (Marks: 1) - Please choose one

Cartels are:

- ▶ **Organizations of independent firms, producing similar products, that work together to raise prices and restrict output.**
- ▶ Organizations of interdependent firms, producing similar products, that work together to raise prices and restrict output.
- ▶ Organizations of independent firms, producing different products, that work together to raise prices and restrict output.
- ▶ Considered as part of monopolistic competition.

Question No: 33 (Marks: 1) - Please choose one

"The situation in which two or more firms set their prices and output according to a plan agreed upon between them in order to divide the market among themselves". Which of the following best describes this situation?

- ▶ Strategic interaction.
- ▶ Monopolistic competition.
- ▶ Oligopoly.
- ▶ **Collusion.**

Question No: 34 (Marks: 1) - Please choose one

Which of the following market situation is much like a pure monopoly except that its member firms tend to cheat on agreed upon price and output strategies?

- ▶ Duopoly.
- ▶ Cartel.
- ▶ Market sharing monopoly.
- ▶ **Natural monopoly.**

Question No: 35 (Marks: 1) - Please choose one

Under the kinked demand curve model, an increase in marginal cost will lead to:

- ▶ An increase in output level and a decrease in price.

- ▶ **A decrease in output level and an increase in price.**
- ▶ A decrease in output level and no change in price.
- ▶ Neither a change in output level nor a change in price.

Question No: 36 (Marks: 1) - Please choose one

Welfare economics is the branch of economics which deals with:

<http://vustudents.ning.com/>

- ▶ Positive issues.
- ▶ **Normative issues.**
- ▶ Micro issues.
- ▶ Macro issues.

Question No: 37 (Marks: 1) - Please choose one

A welfare loss occurs in monopoly where:

- ▶ The price is greater than the marginal cost.
- ▶ The price is greater than the marginal benefit.
- ▶ The price is greater than the average revenue.
- ▶ **The price is greater than the marginal revenue.**

Question No: 38 (Marks: 1) - Please choose one

In monopoly, which of the following is NOT true?

- ▶ **Products are differentiated.**
- ▶ There is freedom of entry and exit into the industry in the long run.
- ▶ The firm is a price maker.
- ▶ There is one main seller.

Question No: 39 (Marks: 1) - Please choose one

Graphically, the Marginal Cost curve cuts through the Average Total Cost curve at:

- ▶ The lowest point on the MC curve.
- ▶ The highest point on the MC curve.
- ▶ **The lowest point on the ATC curve.**
- ▶ The middle of the upward-sloping portion of the total cost curve.

Question No: 40 (Marks: 1) - Please choose one

If current output is less than the profit-maximizing output then which of the following must be TRUE?

- ▶ Total revenue is less than total cost.
- ▶ Average revenue is less than average cost.
- ▶ **Marginal revenue is less than marginal cost.**
- ▶ Marginal revenue is greater than marginal cost.

Question No: 41 (Marks: 1) - Please choose one

A production function:

- ▶ **Relates inputs with output.**
- ▶ Generates a curve that is upward sloping.

▶ Shows diminishing marginal product of an input, since it gets flatter as output rises.

▶ All of the given options.

Question No: 42 (Marks: 1) - Please choose one

A normal good can be defined as one which consumers purchase more of as:

▶ Prices fall.

▶ Prices rise.

▶ Incomes fall.

▶ **Incomes increase.**

Question No: 43 (Marks: 1) - Please choose one

If a market basket is changed by adding more to at least one of the goods, then every consumer will:

▶ Rank the market basket more highly after the change.

▶ Rank the market basket more highly before the change.

▶ **Rank the market basket just as desirable after the change.**

▶ Be unable to decide whether he prefers the first market basket to the second or the second to the first.

Question No: 44 (Marks: 1) - Please choose one

The concept of a risk premium applies to a person that is:

▶ All of the given options.

▶ Risk averse.

▶ Risk neutral.

▶ **Risk loving.**

Question No: 45 (Marks: 1) - Please choose one

Law of diminishing marginal utility indicates that the slope of the marginal utility curve is:

▶ Horizontal.

▶ Vertical.

▶ **Negative.**

▶ Positive.

Question No: 46 (Marks: 1) - Please choose one

The extra value that consumers receive above what they pay for that good is called:

▶ Producer surplus.

▶ Utility.

▶ Marginal utility.

- ▶ **Consumer surplus.**

Question No: 47 (Marks: 1) - Please choose one

If a decrease in price increases the total revenue then:

- ▶ **Demand is elastic.**
- ▶ Demand is inelastic.
- ▶ Supply is elastic.
- ▶ Supply is inelastic.

Question No: 48 (Marks: 1) - Please choose one

The concave shape of the production possibilities curve for two goods X and Y illustrates:

- ▶ **Increasing opportunity cost for both goods.**
- ▶ Increasing opportunity cost for good X but not for good Y.
- ▶ Increasing opportunity cost for good Y but not for good X.
- ▶ Constant opportunity cost for both goods.

Question No: 49 (Marks: 1) - Please choose one

While moving from left to right, the typical production possibilities curve has:

- ▶ **An increasingly steep negative slope.**
- ▶ A decreasingly steep negative slope.
- ▶ An increasingly steep positive slope.
- ▶ A constant and negative slope.

Question No: 50 (Marks: 1) - Please choose one

Our economy is characterized by:

- ▶ **Unlimited wants and needs.**
- ▶ Unlimited material resources.
- ▶ No energy resources.
- ▶ Abundant productive labor.

Question No: 51 (Marks: 5)

Define foreign exchange markets. Also give some examples of foreign exchange markets.

Foreign exchange markets:

The foreign exchange market is a specific system of a country for a foreign trade and currency exchange. For example, if Pakistan imports a product from USA, Pakistan will buy dollars from rupees, so Pakistan exchanged its currency in foreign market.

Foreign markets depend on imports, exports and currency exchanged process. By these ways two countries exchange their markets.

Question No: 52 (Marks: 10)

What will be the role of government in the foreign exchange market in the following cases?

a. If the supply curve of dollars shifts to the right due to rise in exports.

if the supply curve of dollars shifts to the right due to rise in exports, the government role in foreign markets will be very good. Because due to rise in exports government will exchange money and they will gain high price against its currency. The government will increase its exports so it raises the price of its currency in foreign exchange.

b. If the demand curve for dollars shifts to right due to rise in imports.

If the demand curves for dollars shifts to right due to rise in imports, the government should decrease the imports rate to save the currency from falling its price. Basically rise in imports decreases the price of currency in foreign exchange markets. So government will slow down the imports and will try to increase its own products to complete the necessary requirement of the country.

(Marks:5+5)

Question No: 53 (Marks: 10)

Define fiscal policy. Differentiate between contractionary and expansionary fiscal policy. In which situations, budget deficit and budget surplus exist?

Fiscal policy:

Fiscal policy is basically a government policy for expenses, imports, exports of goods, benefits from unemployment, interest on debts etc.

Expansionary fiscal policy:

When there is an increase in government spending, there will be more interest rate of bank loan which government has borrowed for spending.

Contractionary fiscal policy:

In this policy the aggregate demand rises due to increase in unemployment rate of country. Unemployment rise the government expenditures.

(Marks: 2+4+4)

Question No: 54 (Marks: 10)

A.

If there is a gradual increase in the saving rate over time, would this lead to sustained economic growth? Give your answer with brief explanation.

Difinetly, it will increase economic growth rate. As we save more and more money or goods from spendings. Our economical position becomes good. If we have much more savings we can inverst it in a good business or production. This savings will produce more goods and and may be more people will be employed in this process. So our counrty will develop gradually. By this way we will be able top increase our growth rate economically.

B. If this is true, why do people not increase their rate of saving?

Some times People are afraid because of decrease in saving rate and from low exchange rate. They don't put their money in banks. And they sometimes don't invest. For a good economical grwoth extra time is required which more people don't want to wait. Sometimes the savings rate from banks is too low.

C. If there is a higher participation rate and GDP per capita rises, would output per worker also rise? Give your answer with brief explanation.

Yes, because when the rate of GDP per capita rises, there will be more and more chances for employment and the life of people will become standard. They will increase the salaries and wages of workers. By this way the workers will be motivated and they will produce more output.

(Marks:4+3+3)

FINAL TERM EXAMINATION (5)

Fall 2009

ECO401- Economics (Session - 2)

Time: 120 min

Marks: 87

Question No: 1 (Marks: 1) - Please choose one

If pen and ink are complements, then an increase in the price of pen will cause:

- ▶ An increase in the price of ink.
- ▶ **Less ink to be demanded at each price.**
- ▶ A decrease in the demand for pen.
- ▶ A rightward shift in the demand curve for ink.

Question No: 2 (Marks: 1) - Please choose one

A market is said to be in equilibrium when:

- ▶ Demand equals output.
- ▶ There is downward pressure on price.
- ▶ **The amount consumers wish to buy at the current price equals the amount producers wish to sell at that price.**

▶ All buyers are able to find sellers willing to sell to them at the current price.

Ref: A market is said to be in equilibrium when both buyers and sellers are satisfied.

Question No: 3 (Marks: 1) - Please choose one

As more of a good is consumed, then total utility typically:

- ▶ **Increases at a decreasing rate.**
- ▶ Decreases as long as marginal utility is negative.
- ▶ Decreases as long as marginal utility is positive.
- ▶ Is negative as long as marginal utility is decreasing.

Question No: 4 (Marks: 1) - Please choose one

A monopolistically competitive firm in short run equilibrium:

- ▶ Will make negative profit (lose money).
- ▶ Will make zero profit (break-even).
- ▶ Will make positive profit.
- ▶ **Any of the given are possible.**

Question No: 5 (Marks: 1) - Please choose one

A monopolistically competitive firm in the long run equilibrium:

- ▶ Will make negative profit.
- ▶ **Will make zero profit.**
- ▶ Will make positive profit.
- ▶ Any of the given are possible.

Ref: A monopolistically competitive firm in the long run will always break even, or earn only normal profit ensured by entry and exit of firms.

Question No: 6 (Marks: 1) - Please choose one

The market structure in which strategic considerations are most important is:

- ▶ Monopolistic competition.
- ▶ **Oligopoly.**
- ▶ Pure competition.
- ▶ Pure monopoly.

Question No: 7 (Marks: 1) - Please choose one

The price elasticity of demand for any good must be less than or equal to zero unless:

- ▶ The good is a necessity.
- ▶ The good is a luxury.
- ▶ **The good is a Giffen good.**
- ▶ None of the given options.

Ref: <http://www.cengage.co.uk/nicholson/students/mcqs/ch04.htm>

Question No: 8 (Marks: 1) - Please choose one

The textbook for your class was not produced in a perfectly competitive industry because:

- ▶ There are so few firms in the industry that market shares are not small, and firm's decisions have an impact on market price.
- ▶ Upper-division microeconomics texts are not all alike.
- ▶ It is not costless to enter or exit the textbook industry.
- ▶ All of the given options.

Question No: 9 (Marks: 1) - Please choose one

In monopoly, which of the following is NOT true?

- ▶ **Products are differentiated.**
- ▶ There is freedom of entry and exit into the industry in the long run.
- ▶ The firm is a price maker.
- ▶ There is one main seller.

Question No: 10 (Marks: 1) - Please choose one

Under the kinked demand curve model, an increase in marginal cost will lead to:

- ▶ **An increase in output level and a decrease in price.**
- ▶ A decrease in output level and an increase in price.
- ▶ A decrease in output level and no change in price.
- ▶ Neither a change in output level nor a change in price.

Question No: 11 (Marks: 1) - Please choose one

For a firm buying labor competitively, the marginal input cost is equal to the:

- ▶ **Wage.**
- ▶ Interest rate.
- ▶ Price of output.
- ▶ Cost of raw materials.

Question No: 12 (Marks: 1) - Please choose one

The aggregate supply curve is the relationship between:

- ▶ The price level and the real domestic output purchased.
- ▶ **The price level and the real domestic output produced.**
- ▶ The price level which producers are willing to accept and the price level purchasers are willing to pay.
- ▶ The real domestic output purchased and the real domestic output produced.

Ref:http://economics.uakron.edu/faculty/ghosh/2009/prinmacro/Chapter13_AggregateSupplyandDemand.pdf

Question No: 13 (Marks: 1) - Please choose one

The long run aggregate supply curve will shift to the right if:

- ▶ The price level increases.
- ▶ **Factors of production (such as labor and capital) increase.**
- ▶ Expenditures (such as consumption and net exports) increase.
- ▶ The prices of inputs used to produce goods and services (such as wages and the price of oil) decrease.

Question No: 14 (Marks: 1) - Please choose one

Keynesian economics rejected the classical assumption that:

- ▶ **Supply creates its own demand.**
- ▶ Prices and wages are inflexible.
- ▶ Self-correction takes a long time.
- ▶ Consumption expenditures depend on disposable income.

Question No: 15 (Marks: 1) - Please choose one

Which of the following is NOT a stock variable?

- ▶ Government debt.
- ▶ **Capital.**
- ▶ The amount of money held by the public.
- ▶ Inventory investment.

Question No: 16 (Marks: 1) - Please choose one

A nation's balance of payments can be affected by changes in:

- ▶ Foreign income.
- ▶ The differential between domestic and foreign interest rates.
- ▶ **The real exchange rate.**

- ▶ All of the given options.

Question No: 17 (Marks: 1) - Please choose one
Real GDP is equal to:

- ▶ **Nominal GDP – Inflation.**
- ▶ Nominal GDP + Inflation.
- ▶ Nominal GDP/ Inflation.
- ▶ Inflation / Nominal GDP.

Question No: 18 (Marks: 1) - Please choose one
If we compare Gross Domestic Product (GDP) with Gross National Product (GNP) then:

- ▶ $GNP = GDP - \text{Net income from abroad.}$
- ▶ **$GNP = GDP + \text{Net income from abroad.}$**
- ▶ $GNP = NNP - \text{Net income from abroad.}$
- ▶ $GNP = NNP + \text{Net income from abroad.}$

Question No: 19 (Marks: 1) - Please choose one
In Keynesian economics, if aggregate expenditures are less than aggregate output then:

- ▶ The price level rises.
- ▶ Inventories decrease.
- ▶ Employment decreases.
- ▶ **Aggregate output increases.**

Question No: 20 (Marks: 1) - Please choose one
Which of the following is true about supply curve under monopoly?

- ▶ It is same as the competitive market supply curve.
- ▶ **It is the portion of marginal cost curve where marginal costs exceed the minimum value of average variable costs.**
- ▶ It is the result of market power and production costs.
- ▶ None of the given statements is true.

Question No: 21 (Marks: 1) - Please choose one
After the collusion, oligopolists are able to:

- ▶ Raise price but not restrict output.
- ▶ Raise price and restrict output but not attain the monopoly profit.
- ▶ **Raise price and restrict output and therefore attain the monopoly profit.**
- ▶ Restrict output but not raise price.

Question No: 22 (Marks: 1) - Please choose one
Which of the following event will lead towards cost-push inflation and therefore stagflation?

- ▶ **An increase in taxes on individuals.**
- ▶ A decrease in real interest rates.
- ▶ A union settlement that increases wage levels.

- ▶ An increase in government purchases.

Question No: 23 (Marks: 1) - Please choose one

Double counting in national income refers to:

- ▶ Counting a product more than once.
- ▶ **Counting a product at the final stage of output process.**
- ▶ Counting both as product and as factor payment.
- ▶ Counting both as real goods and as money flow.

Ref: http://www.google.com.pk/url?sa=t&source=web&ct=res&cd=1&ved=0CAYQFjAA&url=http%3A%2F%2Fwww.wiziq.com%2Fonline-tests%2F5920-general-economics&rct=j&q=%22Double+counting+in+national+income%22&ei=bk2CS8-jDp-psQa3ooi2BA&usg=AFQjCNGe57Z8lFrowykOmkW_qwWwZuMOOg

Question No: 24 (Marks: 1) - Please choose one

For knowing the spending capacity of the household sector, we have to use the concept of:

- ▶ **National income.**
- ▶ Personal income.
- ▶ Private income.
- ▶ Personal disposable income.

Question No: 25 (Marks: 1) - Please choose one

For a study of the long term growth of the economy, we use:

- ▶ **Real GNP.**
- ▶ Nominal GNP.
- ▶ Personal income.
- ▶ Disposable personal income.

Ref: http://books.google.com.pk/books?id=tugDAAAAMBAJ&pg=PT81&lpg=PT81&dq=%22For+a+study+of+the+long+term+growth+of+the+economy,+we+use%22&source=bl&ots=_HLRcpeuvr&sig=2xoGxoF9ij6Xnhpl0etubXCDi0o&hl=en&ei=YE6CS-XQJpfgsAbvxITaBA&sa=X&oi=book_result&ct=result&resnum=1&ved=0CAcQ6AEwAA#v=onepage&q=%22For%20a%20study%20of%20the%20long%20term%20growth%20of%20the%20economy%2C%20we%20use%22&f=false

Question No: 26 (Marks: 1) - Please choose one

Which of the following is an example of a leakage?

- ▶ Saving.
- ▶ Investment.
- ▶ **Exports.**
- ▶ Government expenditures.

Question No: 27 (Marks: 1) - Please choose one

Total product of labor per day is shown in the following table and the price of the product is \$10/unit. What is the value of the marginal product of labor (VMPL) of the 3rd worker?

Labor	Total Product
-------	---------------

1	10
2	25
3	35
4	40
5	41

- ▶ 5.
- ▶ **10.**
- ▶ 50.
- ▶ 100.

Question No: 28 (Marks: 1) - Please choose one

In the short run, the equilibrium price level and the equilibrium level of total output are determined by the intersection of:

▶ The aggregate demand, the short-run aggregate supply and the long-run aggregate supply curves.

▶ The short-run aggregate supply and the long-run aggregate supply curves.

▶ **The aggregate demand and the short-run aggregate supply curves.**

▶ The aggregate demand and the long-run aggregate supply curves.

Ref: <http://www.flatworldknowledge.com/pub/1.0/principles-macroeconomics/29991>

Question No: 29 (Marks: 1) - Please choose one

What is the interest rate effect that explains why the aggregate demand curve slopes downward?

▶ It refers to the effect of changes in the price level on quantity of investment demanded which in turn affects interest rates.

▶ It refers to the effect of interest rates on borrowing which in turn affects consumption spending.

▶ **It refers to the effect of changes in the price level on interest rates which in turn affects the quantity of investment demanded.**

▶ It refers to the shifts in aggregate demand when interest rates change.

Question No: 30 (Marks: 1) - Please choose one

In the classical world, you could always get a job if you:

▶ Had a good education.

▶ Worked in an industry that was recession proof.

▶ Had unemployment in the manufacturing sector.

▶ **Would accept a lower wage.**

Question No: 31 (Marks: 1) - Please choose one

The level of output produced when the labor market is in equilibrium is called:

▶ Target output.

▶ Product market equilibrium output.

▶ **Full-employment output.**

▶ Natural output.

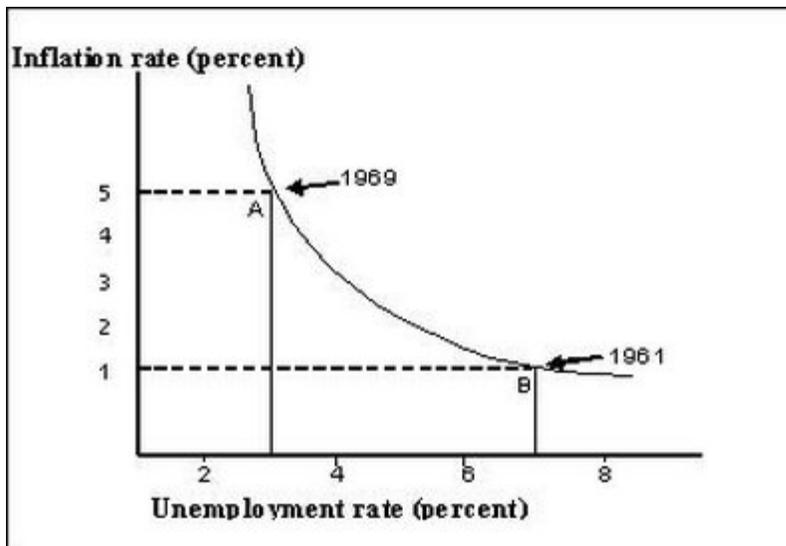
Question No: 32 (Marks: 1) - Please choose one

Which of the following economists came up with a theory regarding the tradeoff between unemployment and inflation?

► **A.W. Phillips.**

- John Maynard Keynes.
- Joseph Schumpeter.
- Milton Friedman.

Question No: 33 (Marks: 1) - Please choose one



**Refer to the above figure, moving from B to A shows a tradeoff of:
Refer to the above figure, moving from B to A shows a tradeoff of:**

- More unemployment for less inflation.
- **Less unemployment for more inflation.**
- A fixed amount of unemployment for more inflation.
- Less unemployment for less inflation.

Question No: 34 (Marks: 1) - Please choose one

Falling inflation means:

- That the price level is falling from one period to the next.
- That the price level is falling at a decreasing rate.
- That the price level is falling at an increasing rate.
- **That the price level is increasing at a decreasing rate.**

Question No: 35 (Marks: 1) - Please choose one

Disposable Personal Income \$	Consumption \$
100	140
200	220
300	300
400	380
500	460

Refer to the above table, when disposable personal income is \$300, what is the amount of personal saving?

- -\$40.

- ▶ -\$20.
- ▶ **\$0.**
- ▶ \$20.

Question No: 36 (Marks: 1) - Please choose one
The real exchange rate is defined as the:

- ▶ **Market exchange rate adjusted for prices.**
- ▶ Market exchange rate adjusted for interest rates.
- ▶ Market exchange rate.
- ▶ Exchange rate determined by the government.

Question No: 37 (Marks: 1) - Please choose one
The interest rate parity is the basic identity that relates which of the following?

- ▶ **Interest rates and exchange rates.**
- ▶ Interest rates and inflation rate.
- ▶ Exchange rates and inflation rate.
- ▶ Discount rate and inflation rate.

Question No: 38 (Marks: 1) - Please choose one
Suppose there is a steady state condition in an economy with no population growth. In which condition, the steady-state level of capital per worker will increase?

- ▶ When the amount of investment per worker decreases.
- ▶ When the depreciation rate increases.
- ▶ **When the saving rate increases.**
- ▶ In all of the given options.

Question No: 39 (Marks: 1) - Please choose one
“Government collects zero revenue if the tax rate is 0% and if the tax rate is 100%.” Which of the following best describes this statement?

- ▶ Consumption curve.
- ▶ Supply curve.
- ▶ **Laffer curve.**
- ▶ Investment curve.

Ref: en.wikipedia.org/wiki/Laffer_curve

Question No: 40 (Marks: 1) - Please choose one
A tax on the accounting profits of corporations is known as:

- ▶ Sales tax.
- ▶ Excise tax.
- ▶ **Corporate income tax.**
- ▶ Personal income tax.

Ref: <http://quizlet.com/725121/economics-flash-cards/>

Question No: 41 (Marks: 1) - Please choose one
Which of the following shows the functions of money?

- ▶ **A conductor of economic activity, a medium of exchange, and a store of value.**
- ▶ A medium of exchange, a store of value, and a factor of production.
- ▶ A store of value, a medium of exchange, and a determinant of investment.
- ▶ A store of value, a unit of account, and a medium of exchange.

Question No: 42 (Marks: 1) - Please choose one

Which of the following best describes a bank's reserves?

- ▶ The minimum value of assets it must have.
- ▶ The amount of gold it is required to have as reserves against loans.
- ▶ **The value of federal securities it is required to have as reserves against loans.**
- ▶ Deposits that bank has accepted from customers but have not loaned out.

Question No: 43 (Marks: 1) - Please choose one

The special importance of banks among the financial institutions arises from:

- ▶ Their large and heavy transactions.
- ▶ Their position as suppliers of money.
- ▶ Their power to create money.
- ▶ **Their influence on the economy.**

Question No: 44 (Marks: 1) - Please choose one

Which of the following will be TRUE if real income rose and the interest rate fell following an increase in government purchases?

- ▶ IS curve must be vertical.
- ▶ LM curve must be vertical.
- ▶ **Central Bank must have increased the money supply at the same time.**
- ▶ Central Bank must have decreased the money supply at the same time.

Question No: 45 (Marks: 1) - Please choose one

If money supply is fixed by the central bank then in interest rate-money supply space, money supply curve will be:

- ▶ Horizontal.
- ▶ Vertical.
- ▶ Negatively sloped.
- ▶ **Positively sloped.**

Question No: 46 (Marks: 1) - Please choose one

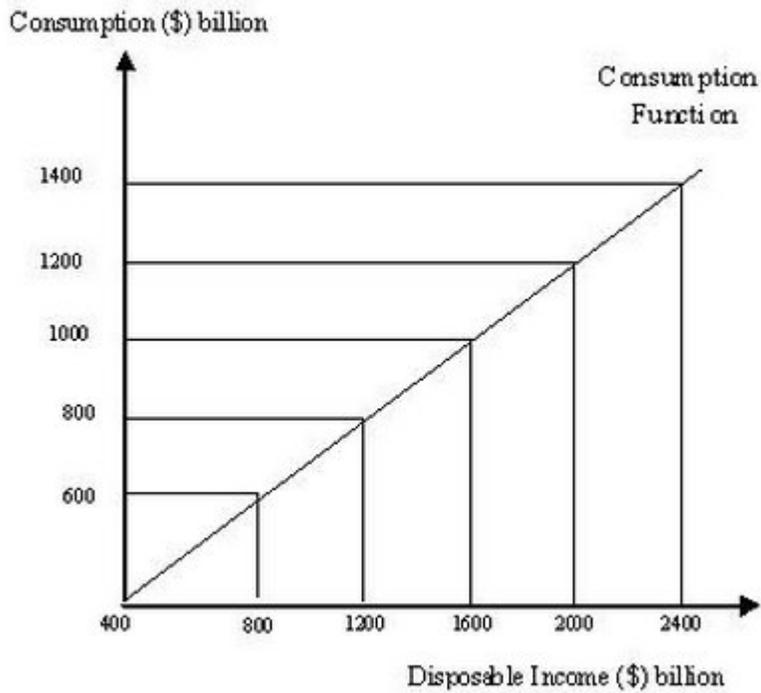
Why agriculture sector has an important role to play in the development process?

▶ Because a balanced approach to growth is necessary.
▶ Because the vast majority of an under developed country is engaged in agriculture.

▶ **Because agriculture may be a major bottleneck in the process of development.**

▶ Because of all of the given options.

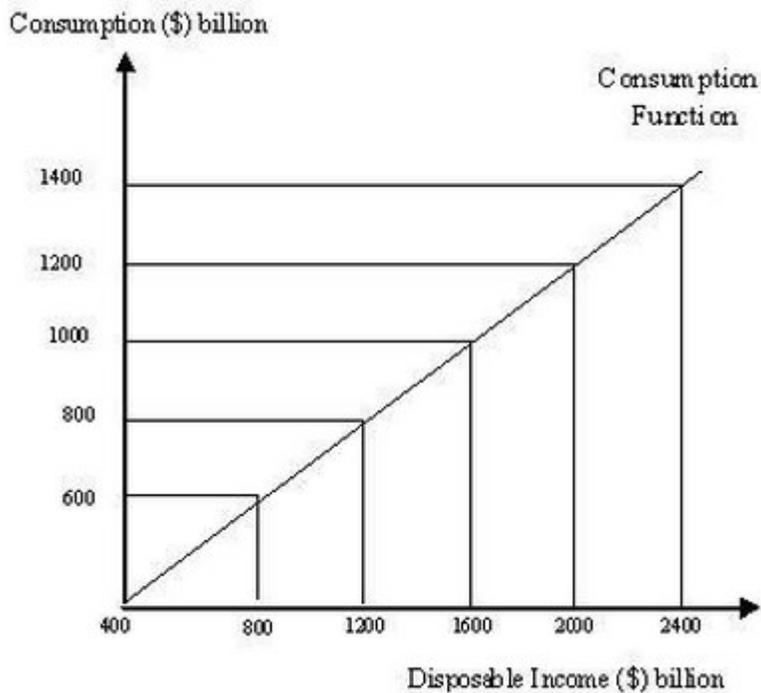
Question No: 47 (Marks: 1) - Please choose one



Refer to the above figure, the marginal propensity to consume is:

- ▶ 0.25.
- ▶ 0.50.
- ▶ 0.60.
- ▶ **0.67.**

Question No: 48 (Marks: 1) - Please choose one



Refer to the above figure, when disposable personal income is \$2,000 billion:

- ▶ Personal saving is \$1,200 billion.
- ▶ Consumption is \$1,600 billion.
- ▶ **Saving is \$800 billion.**
- ▶ Consumption is \$800 billion.

Question No: 49 (Marks: 1) - Please choose one

What is meant by the negative slope of a production possibilities curve?

- ▶ It means that some resources are always unemployed.
- ▶ **It means that an economy can produce more of one thing only by producing less of something else.**
- ▶ It means that opportunity costs are constant.
- ▶ It means that business can sell more when prices are low.

Question No: 50 (Marks: 1) - Please choose one

Which of the following is TRUE for a Giffen good?

- ▶ Its marginal utility is zero.
- ▶ **Its demand curve is perfectly elastic.**
- ▶ Its substitution effect is positive.
- ▶ Its demand curve is positively sloped.

Question No: 51 (Marks: 1) - Please choose one

Which of the following occur when an isocost line is just tangent to an isoquant?

- ▶ **Output is being produced at minimum cost.**
- ▶ Output is not being produced at minimum cost.
- ▶ The two products are being produced at the medium input cost to the firm.
- ▶ The two products are being produced at the highest input cost to the firm.

Ref: http://econweb.rutgers.edu/besedes/sample_exam2_intermediate.pdf

Question No: 52 (Marks: 1) - Please choose one

Which of the following is TRUE about L-shaped isoquant?

- ▶ It indicates that the firm could switch from one output to another costlessly.
- ▶ It indicates that the firm could not switch from one output to another.
- ▶ **It indicates that capital and labor cannot be substituted for each other in production.**
- ▶ It is impossible.

Question No: 53 (Marks: 1) - Please choose one

The total cost (TC) function is given as: $TC = 200 + 5Q$. What is the fixed cost?

- ▶ 5Q.
- ▶ 5.
- ▶ $5 + (200/Q)$.
- ▶ **200.**

Question No: 54 (Marks: 1) - Please choose one

The total cost (TC) function is given as: $TC = 200 + 5Q$. What is the average total cost?

- ▶ 5Q.
- ▶ 5.
- ▶ **$5 + (200/Q)$.**
- ▶ None of the given options.

Question No: 55 (Marks: 3)

Define consumption function. Write down the determinants of consumption.

Consumption and Consumption Function:

Consumption (C) is the amount of national income that is spent on goods and services produced by domestic firms in a given period of time. Consumption is the most stable and important component of aggregate demand, accounting for about two-thirds to three-fourths of GDP in most countries.

The consumption function is a schedule relating total consumption to personal disposable income. It usually takes the form $C = a + bY_d = a + b(Y - T)$, where a is the minimum level of consumption that must take place even if Y_d is zero, and b is the marginal propensity to consume.

Determinants of consumption

Thus there are two determinants of consumption (namely income and taxation, which will not cause saving to rise if consumption is caused to fall.

Question No: 56 (Marks: 5)

The paradox of thrift is demonstrated algebraically by equating leakages and injections. Suppose the Saving function is specified as $S = -\$10 \text{ billion} + 0.2Y$, Gross imports equal \$70 billion, Investment is \$100 billion and Gross exports equal \$70 billion. Calculate the equilibrium level of output by using leakages-injections approach.

Question No: 57 (Marks: 5)

Country	Commodity	Amount that can be produced in 1 year
USA	Cotton	40 units
	Food	60 units
UK	Cotton	30 units
	Food	20 units

A. Consider there is no international trade. See the above table and answer which country has absolute advantage in which product?

B. Draw the production possibility frontiers for USA and UK.

(Marks: 2+3)

Question No: 58 (Marks: 10)

A. From the information given below, calculate the following:

- a) Nominal GDP in year 1
- b) Nominal GDP in year 2
- c) Growth rate in nominal GDP

	Year 1	Year 2
Apples produced	100	150
Chicken produced	100	140
Cost per apple (Rs.)	2	4
Cost per chicken (Rs.)	4	6

B. Suppose that in the economy of Pakistan, the Real Gross National Product

in 1987 was 1483 billion. In 1988, Real Gross National Product was 1510 billion. Calculate the growth rate of real Gross National Product from this information. (Marks: 6+4)

Question No: 59 (Marks: 10)

(A) Following table shows the income earned by different factors of production.

Serial #	Rewards	Amount (billion rupees)
1	Wages and salaries	150.52
2	Interest on bonds and loans	50.63
3	Rent of properties	100.12
4	Profit	125.84
5	Corporate profit tax	50.26
6	Undistributed corporate profit	30.32
7	Contributions for social security	20.20

Find out the national income from this information.

(B) Although GDP provide us a good estimate about the overall production of the economy, but still it has some flaws. Discuss those flaws.

(Marks: 4+6)

FINALTERM EXAMINATION (6)

Fall 2009

ECO401- Economics

Solved & Shared By

Time: 120 min

Marks: 87

Question No: 1 (Marks: 1) - Please choose one

The concave shape of the production possibilities curve for two goods X and Y illustrates: <http://vustudents.ning.com/>

► Increasing opportunity cost for both goods.

► Increasing opportunity cost for good X but not for good Y.

► Increasing opportunity cost for good Y but not for good X.

► Constant opportunity cost for both goods.

The shape of a production possibility curve commonly drawn as concave downward to represent increasing opportunity cost with increased output of a good.

Question No: 2 (Marks: 1) - Please choose one

When college students leave town for the summer, the demand for meals at the local restaurants decline. This results in:

► A decrease in equilibrium price and an increase in quantity of meal.

► An increase in equilibrium price and quantity of meal.

► A decrease in equilibrium price and quantity of meal.

► An increase in equilibrium price and a decrease in quantity of meal.

A decrease in equilibrium price and quantity. The demand curve shifts to the left because the town population declines, resulting in lower prices and quantity.

Question No: 3 (Marks: 1) - Please choose one
A demand curve is price elastic when:

- ▶ **Changes in demand are proportionately greater than changes in price.**
- ▶ Changes in demand are equal to changes in price.
- ▶ None of the given options.
- ▶ Changes in demand are proportionately smaller than changes in price.

For elastic demand curve, firm does not increase its prices. Because as prices increases, quantity Demanded decreases much larger. Decrease in quantity demanded is greater than the increase in prices. So firm will earn less revenue. So TR decreases as price increases.

Question No: 4 (Marks: 1) - Please choose one

The numerical measurement of a consumer's preference is called:

- ▶ Use.
- ▶ Pleasure.
- ▶ **Utility.**
- ▶ Satisfaction.

Utility is a numerical representation of a preference ranking

Question No: 5 (Marks: 1) - Please choose one

Which of the following is TRUE about price-consumption curve for good X?

- ▶ Nominal income falls as the price of X falls.
- ▶ The absolute price of X falls, but the relative price between X and the composite good Y stays the same.
- ▶ It is always downward sloping for a normal good.

▶ It represents only those market baskets that are optimal for the given price ratio and preference pattern and therefore a demand curve can be plotted from it.

The price consumption curve (PCC) traces out the optimal choice of consumption at different prices. The PCC can be used to derive the demand curve, which shows the relationship between price & quantity demanded.

Question No: 6 (Marks: 1) - Please choose one

Marginal profit is equal to:

- ▶ **Marginal revenue minus marginal cost.**
- ▶ Marginal revenue plus marginal cost.
- ▶ Marginal cost minus marginal revenue.
- ▶ Marginal revenue times marginal cost.

marginal profit is the term used to refer to total when marginal cost is subtracted from marginal revenue.

Question No: 7 (Marks: 1) - Please choose one

The supply curve for a competitive firm is:

- ▶ Its entire marginal cost curve.
- ▶ The upward-sloping portion of its marginal cost curve.
- ▶ Its marginal cost curve above the minimum point of the average variable cost

curve.

▶ Its marginal cost curve above the minimum point of the average total cost curve.

A perfectly competitive firm's supply curve is that portion of its marginal cost curve that lies above the minimum of the average variable cost curve.

Question No: 8 (Marks: 1) - Please choose one

Second-degree price discrimination is the practice of charging:

- ▶ The reservation price to each customer.
- ▶ **Different prices for different blocks of the same good or service.**
- ▶ Different groups of customers different prices for the same products.
- ▶ Each customer the maximum price that he or she is willing to pay.

Second degree price discrimination, allows the supplier to set different prices to the different groups and capture a larger portion of the total market surplus.

Question No: 9 (Marks: 1) - Please choose one

A market with few entry barriers and with many firms that sell differentiated products is:

- ▶ Purely competitive.
- ▶ A monopoly.
- ▶ **Monopolistically competitive.**
- ▶ Oligopolistic.

Monopolistic competition is also characterized by a large number of buyers and sellers and absence of entry barriers.

Question No: 10 (Marks: 1) - Please choose one

The market structure in which strategic considerations are most important is:

- ▶ Monopolistic competition.
- ▶ **Oligopoly.**
- ▶ Pure competition.
- ▶ Pure monopoly.

Question No: 11 (Marks: 1) - Please choose one

The price elasticity of demand for any good must be less than or equal to zero unless:

- ▶ The good is a necessity.
- A good for which the "income elasticity of demand" is >0 & <1
- ▶ The good is a luxury.
- A good for which the "income elasticity of demand" is > 1 .

- ▶ **The good is a Giffen good.**
- ▶ None of the given options.

Goods for which the "quantity demanded" of one good does not depend upon the price of the other. (i.e. Pencils & cars). The "cross elasticity of demand" will be 0.

Question No: 12 (Marks: 1) - Please choose one
Consumption spending, investment expenditures, government expenditures and net exports are:

- ▶ The components of household income.
- ▶ The components of aggregate supply.

▶ **The components of aggregate demand**

- ▶ The components of government revenue.

AD is the sum of consumption, investment, government spending and net exports (i.e. exports minus imports), and is inversely related to the aggregate price level through the wealth, interest rate and international purchasing power effects.

Question No: 13 (Marks: 1) - Please choose one
Classical economics was replaced as the dominant theory of macroeconomic analysis by:

- ▶ Monetarism.
- ▶ Rational expectations.
- ▶ **Keynesian economics.**
- ▶ Neoclassical economics.

Question No: 14 (Marks: 1) - Please choose one
According to classical economics, the economy will always tend toward full employment due to:

- ▶ Minimum wages.
- ▶ **Flexible wages and prices.**
- ▶ Extended periods of unemployment.
- ▶ Inequality between saving and investment.

Question No: 15 (Marks: 1) - Please choose one
The real interest rate will increase:

- ▶ **If there is an excess supply of loanable funds in the financial markets.**
- ▶ If there is an excess demand for loanable funds in the financial markets.
- ▶ If there is an excess supply of loanable funds in the foreign exchange markets.
- ▶ If there is an excess demand for loanable funds in the foreign exchange markets.

Question No: 16 (Marks: 1) - Please choose one
A source of fluctuations in investment spending is:

- ▶ Changes in government expectations of future output growth.
- ▶ Changes in household's expectations about future output growth.
- ▶ Changes in household's expectations about future risk.
- ▶ **Changes in investor's expectations about future profits.**

Question No: 17 (Marks: 1) - Please choose one
What does the term "balance of payment deficit" refer to?

- ▶ An increase in official international reserves.
- ▶ A positive statistical discrepancy.
- ▶ A negative statistical discrepancy.
- ▶ **A decline in official international reserves.**

Question No: 18 (Marks: 1) - Please choose one
M1 component of money supply consists of:

- ▶ Paper currency and coins.
- ▶ **Paper currency, coins and check writing deposits.**
- ▶ Paper currency, coins, check writing deposits and savings deposits.
- ▶ Paper currency, coins, check writing deposits, savings deposits and certificates of deposits.

M1 includes currency held by the public, plus travelers' checks, demand deposits, other checkable deposits (including negotiable order of withdrawal (NOW) accounts, Automatic Transfer Service (ATS) accounts, and credit union share draft accounts).

Question No: 19 (Marks: 1) - Please choose one

When one producer can produce a given amount of output with fewer inputs, which of the following would occur?

- ▶ Comparative advantage.
- ▶ Comparative disadvantage.
- ▶ **Absolute advantage.**
- ▶ Absolute disadvantage.

Absolute advantage.: Capability of one producer to produce a given good using fewer resources than any other producer.

Question No: 20 (Marks: 1) - Please choose one

What would result from a depreciation of the pound on the foreign exchange market?

- ▶ An increase in the price of imported computers.
- ▶ A fall in the purchasing power of US tourists in London.
- ▶ **A fall in the price of imported computers.**
- ▶ An increase in the purchasing power of UK tourists overseas.

A currency is said to depreciate in value if its exchange rate decreases, such as a decrease in the exchange rate of dollars from 0.5 pounds per dollar to 0.33 pounds per dollar. Currency depreciation makes exports from the country relatively less expensive resulting in more exports and usually fewer imports.

Question No: 21 (Marks: 1) - Please choose one

The news on the television reports that the dollar has strengthened relative to the Japanese yen. This means that:

- ▶ The dollar can now purchase more yen.
- ▶ The US trade balance with the Japanese economy has improved.

▶ **The yen can now purchase more dollars.**

▶ The dollar has depreciated relative to the yen.

The exchange rate increases (i.e., a unit of your currency is worth more in foreign currency than previously), the currency is said to have *strengthened, appreciated, or increased in value* (revaluation). For example, assume that the exchange rate between the U.S. dollar and the Japanese yen changed from US\$1=104 yen to US\$1=110 yen. This would strengthen the value of the U.S. dollar in that you would receive more yen in exchange for your dollar

Question No: 22 (Marks: 1) - Please choose one

In Keynesian economics, if aggregate expenditures are less than aggregate output then:

▶ The price level rises.

▶ Inventories decrease.

▶ Employment decreases.

▶ **Aggregate output increases.**

Question No: 23 (Marks: 1) - Please choose one

In the Keynesian cross model, the aggregate expenditure line has a slope of:

▶ 1.

▶ 0.

▶ Infinity.

▶ **Less than 1.**

In the Keynesian cross model If we draw a graph with expenditure on the vertical axis, we can see that the Expenditure line should have a slope of (<1),

Question No: 24 (Marks: 1) - Please choose one

Demand is elastic when the elasticity of demand is:

▶ Greater than 0 but less than 1.

▶ **Greater than 1.**

▶ Less than 0.

▶ Equal to 1. **unit elastic**

If $P_{ed} > 1$, then demand responds more than proportionately to a change in price i.e. demand is elastic.

Question No: 25 (Marks: 1) - Please choose one

Which of the following statements is TRUE about cartels?

▶ These are considered as part of monopolistic competition.

▶ these are organizations of independent firms, producing similar products, that work together to raise prices and restrict output.

▶ **these are organizations of interdependent firms, producing similar products, that work together to raise prices and restrict output.**

▶ These are organizations of independent firms, producing different products, that work together to raise prices and restrict output.

A cartel is a formal (explicit) agreement among firms. Cartels usually occur in an oligopolistic industry, where there are a small number of sellers and usually involve homogeneous products.

Question No: 26 (Marks: 1) - Please choose one

After the collusion, oligopolists are able to:

- ▶ Raise price but not restrict output.
- ▶ Raise price and restrict output but not attain the monopoly profit.
- ▶ **Raise price and restrict output and therefore attain the monopoly profit.**
- ▶ Restrict output but not raise price.

Question No: 27 (Marks: 1) - Please choose one

Which of the following statements is TRUE about the difference between nominal and real Gross Domestic Product (GDP)?

- ▶ Real GDP includes only goods; nominal GDP includes goods and services.
- ▶ **Real GDP is measured using constant base-year prices; nominal GDP is measured using current prices.**
- ▶ Real GDP is equal to nominal GDP less the depreciation of the capital stock.
- ▶ Real GDP is equal to nominal GDP multiplied by the CPI.

Nominal GDP: The total market value, measured in current prices,

Real GDP: The total market value, measured in constant prices

Question No: 28 (Marks: 1) - Please choose one

If production remains the same and all prices double, then which of the following will happen?

- ▶ Real GDP and nominal GDP will both remain constant.
- ▶ Real GDP will remain constant and nominal GDP will reduce by half.
- ▶ **Real GDP will remain constant and nominal GDP will double.**
- ▶ Real GDP will double and nominal GDP will remain constant.

Question No: 29 (Marks: 1) - Please choose one

Assume that there is no government or foreign sector, if the marginal propensity to consume (MPC) is 0.9, then the value of multiplier will be equal to:

- ▶ 2.
- ▶ 5.
- ▶ 8.
- ▶ 10.

NO IDEA... MAY BE WRONG QUESTION

Question No: 30 (Marks: 1) - Please choose one

Firm A produces cotton worth Rs. 1000 and sells it to firm B. From this, firm B makes yarn worth Rs. 1500 and sells to firm C. Firm C manufactures cloth worth Rs. 2500 and sells to consumers. The value added is:

- ▶ **1000+1500+2500 = Rs. 5000**
- ▶ 1000+500+2500 = Rs. 4000
- ▶ 1000+500+1000 = Rs. 2500
- ▶ 1000+1500+1000 =Rs. 3500

Question No: 31 (Marks: 1) - Please choose one

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Which of the following is a transfer payment?

- ▶ Payment made to housewife.
- ▶ Pocket allowance to children.
- ▶ Maintenance allowance to old parents.
- ▶ **All of the given options.**

Question No: 32 (Marks: 1) - Please choose one

The relationship between hours provided by labor and wage rate is:

- ▶ **Positive.**
- ▶ Negative.
- ▶ Ambiguous.
- ▶ Very strong.

Question No: 33 (Marks: 1) - Please choose one

Market failure occurs when:

- ▶ Competitive markets do not achieve equitable outcomes.
- ▶ Competitive markets do not achieve efficient outcomes.
- ▶ Government takes steps to intervene in markets.
- ▶ **All of the given happen.**

Question No: 34 (Marks: 1) - Please choose one

A graph that depicts the relationship between the total quantity of goods and services demanded and the price level is known as:

- ▶ **Aggregate demand curve.**
- ▶ Average price level.
- ▶ Circular flow model.
- ▶ GDP curve.

The aggregate demand curve illustrates the relationship between economic goods demanded and the price level, assuming all else is held constant (that is, under aceteris paribus assumption).

Question No: 35 (Marks: 1) - Please choose one

In the short run, the equilibrium price level and the equilibrium level of total output are determined by the intersection of:

- ▶ The aggregate demand, the short-run aggregate supply and the long-run aggregate supply curves.
- ▶ The short-run aggregate supply and the long-run aggregate supply curves.
- ▶ The aggregate demand and the short-run aggregate supply curves.
- ▶ The aggregate demand and the long-run aggregate supply curves.

Question No: 36 (Marks: 1) - Please choose one

Changes in aggregate demand can be caused by changes in:

- I. Wages.
- II. Raw materials costs.
- III. **Government spending.**
- IV. Government regulations that increase the cost of doing

business.

- ▶ I, II, III, and IV.
- ▶ I and III only.
- ▶ I, III, and IV.
- ▶ **III only.**

Question No: 37 (Marks: 1) - Please choose one

In the long run, the output level is determined by:

- ▶ Aggregate demand.
- ▶ **Aggregate supply.**
- ▶ The government.
- ▶ Household income.

Long run aggregate supply (LRAS): LRAS shows total planned output when both prices and average wage rates can change – it is a measure of a country's potential output and the concept is linked strongly to that of the **production possibility frontier**

Question No: 38 (Marks: 1) - Please choose one

Which of the following is TRUE?

- ▶ **$1 - \text{MPS} = \text{MPC}$**
- ▶ $1 + \text{MPS} = \text{MPC}$
- ▶ $1 / \text{MPS} = \text{MPC}$
- ▶ $1 \times \text{MPS} = \text{MPC}$

(MPS) is the fraction of the additional dollar of disposable income that is Saved. Thus, $\text{MPC} = 1 - \text{MPS}$.

Question No: 39 (Marks: 1) - Please choose one

The above figure shows disposable personal income on the horizontal axis and consumption per period on the vertical axis. Which of the following is TRUE at every point on the 45-degree line?

- ▶ The value of disposable income equals the sum of personal saving and consumption.
- ▶ The value of disposable income equals consumption.
- ▶ The value of disposable income equals personal saving.
- ▶ The value of disposable income and consumption equals 1.

Question No: 40 (Marks: 1) - Please choose one

If the government wishes to achieve a fall in unemployment, which of the following policies should it adopt?

- ▶ Reduce the real value of income tax free allowances.
- ▶ Reduce government spending on capital projects.
- ▶ Raise Value Added Tax (VAT).
- ▶ **Start public job training programs.**

Question No: 41 (Marks: 1) - Please choose one

In the long run, sustained inflation is due to:

- ▶ A one-time increase in money growth.
- ▶ **A continuous increase in the money growth rate.**
- ▶ A continuous increase in aggregate demand.

- ▶ The rising price of oil.

Question No: 42 (Marks: 1) - Please choose one

The situation when a country imports more than it exports is known as:

- ▶ **A trade deficit.**
- ▶ A trade surplus.
- ▶ An expansion.
- ▶ A recession.

A negative balance of trade, i.e. imports exceed exports. opposite of trade surplus.

Question No: 43 (Marks: 1) - Please choose one

Public investment expenditure for highways, schools, and national defense is included in which component of GDP?

- ▶ Consumption.
- ▶ Gross private investment.
- ▶ **Government purchases.**
- ▶ Public investment.

Question No: 44 (Marks: 1) - Please choose one

The government has a balanced budget if:

- ▶ **Its total revenues are equal to its total expenditures.**
- ▶ Its total revenues are less than its total expenditures.
- ▶ Its total revenues are greater than its total expenditures.
- ▶ The money supply is less than total expenditures.

Question No: 45 (Marks: 1) - Please choose one

In general, personal income taxes:

- ▶ Rise automatically during a recession.
- ▶ **Rise automatically during an expansion.** Not sure
- ▶ Fall automatically during an expansion.
- ▶ Remains same in all phases of economic fluctuations.

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Question No: 46 (Marks: 1) - Please choose one

A tax on individual's income is known as:

- ▶ Sales tax.
- ▶ Excise tax
- ▶ Corporate income tax.
- ▶ **Personal income tax.**

Personal income tax: A tax on individual income. This is the primary source of revenue for the federal government, a big source for many state and local governments. In principle, personal income taxes are progressive, based on a graduated tax scale. However, it's much more proportional today than it was several decades ago.

Question No: 47 (Marks: 1) - Please choose one

Which of the following is TRUE for banks?

- ▶ **They deal with money only.**
- ▶ They deal with shares and assets.
- ▶ They not only deal with money but also create money.
- ▶ They deal with money but do not create money.

Question No: 48 (Marks: 1) - Please choose one

In a period of boom, credit creation is:

- ▶ Small.
- ▶ **Heavy.**
- ▶ Unchanged.
- ▶ Zero.

Question No: 49 (Marks: 1) - Please choose one

What will be the impact of an increase in taxes?

- ▶ It will shift the IS curve to the left and decrease both the interest rate and the level of income.
- ▶ It will shift the IS curve to the right and increase both the interest rate and the level of income.
- ▶ It will shift the IS curve to the right and increase the level of income but decrease the interest rate.
- ▶ **It will shift the LM curve downward (to the right) and increase the level of income but decrease the interest rate.** Not sure

Question No: 50 (Marks: 1) - Please choose one

To determine whether an economy's output is growing or shrinking, one must keep track of:

- ▶ Changes in nominal GDP.
- ▶ Changes in the growth rate of nominal GDP.
- ▶ Changes in the general price level.
- ▶ **Changes in real GDP.**

Economic growth is increase in an economy's level of production, output or income. We can talk about production or output in two broad definitional contexts. One, we can compare real GDP with some other measure of welfare (for e.g., one which adjusts for externalities, social indicators, the black market, purchasing power parity, income inequality etc.).

Question No: 51 (Marks: 1) - Please choose one

Suppose the price of rail tickets decreases, what will happen to the demand for airline travel?

- ▶ **The demand curve for airline travel shifts left.**
- ▶ The demand curve for airline travel shifts right.
- ▶ The supply curve of airline travel shifts left.
- ▶ The supply curve of airline travel shifts right.

The demand curve shifts left. Rail and airline travel are substitutes. If the price of a substitute declines, then the demand curve for the substitute product shifts to the left.

Question No: 52 (Marks: 1) - Please choose one

Production possibilities curve will shift upward if there is:

- ▶ A reduction in unemployment.
- ▶ **An increase in the production of capital goods.**
- ▶ A reduction in discrimination.
- ▶ All of the given options.

Question No: 53 (Marks: 1) - Please choose one

Which of the following is NOT included in the perfect information assumption of

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perfect competition?

- ▶ Consumers know their preferences.
- ▶ Consumers know their income levels.
- ▶ Consumers know the prices available.
- ▶ **Consumers can anticipate price changes.**

Question No: 54 (Marks: 1) - Please choose one

Suppose a monopolist set his output at the level where marginal revenue, marginal cost and average total cost are equal. In this case, economic profit will be:

- ▶ Negative.
- ▶ **Positive.**
- ▶ Zero.
- ▶ Indeterminate from the given information.

As profit is maximized at the point where $MR = MC$,
Depending upon the level of **AC at the point where $MR=MC$** , the monopolist might be

earn supernormal profits, breaking even or minimizing short run losses.

Question No: 55 (Marks: 3)

Differentiate between the terms flow and stock.

Stocks and those which are flows; these differ in their units of measurement. A stock variable is measured at one specific time, and represents a quantity existing at that point in time, which may have been accumulated in the past. A flow variable is measured over an interval of time. Therefore a flow would be measured per unit of time.

Stocks and flows have different units and are thus not commensurable – they cannot be meaningfully compared, equated, added, or subtracted. However, one may meaningfully take ratios of stocks and flows, or multiply or divide them.

Question No: 56 (Marks: 5)

What should be the optimal role of government in an economy according to the Classical school of thought? Discuss.

Question No: 57 (Marks: 5)

Explain the difference between current account and capital account.

Current account :

Current account is one of the two primary components of the balance of payments, the other being the capital account. It is the sum of the balance of trade (exports minus imports of goods and services).

Current account = balance of trade + net factor income from abroad + net unilateral transfers from abroad

Current account deals with international trade in goods and services and with earnings on investments.

Capital account:

The capital account consists of capital transfers and the acquisition and disposal of non-produced, non-financial assets. A subdivision of the capital account, the financial account records transfers of financial capital and non-financial capital. The official reserves account, which is part of the financial account, is the foreign currency held by central banks, and is used to pay balance-of-payment deficits. Each account is further divided into sub-accounts.

Question No: 58 (Marks: 10)

(A) The above demand curve has two distinct segments which have different elasticities that join to form a corner or kink. Why the firms are reluctant to change the price in these two segments?

(B) What are the major advantages that an oligopoly offers for public interests?

(Marks: 5+5)

Question No: 59 (Marks: 10)

The items of balance sheet of State Bank of Pakistan are given as follows:

Forex reserves = Rs. 500

Notes and coins = Rs. 800

Credit to government = Rs. 200

Government and commercial bank deposits = Rs. 300

Credit to private sector = Rs. 700

Liquidity paper = Rs. 300

Prepare the balance sheet in its proper format of asset and liabilities side. Also calculate total assets and total liabilities.

Solution: (this question solved by kash again)

Assets	Liabilities
Forex reserves = Rs. 500	Government and commercial bank deposits = Rs. 300
Credit to government = Rs. 200	Notes and coins = Rs. 800
Credit to private sector = Rs. 700	Liquidity paper = Rs. 300
Total= RS 1400	Total= RS 1400

FINAL TERM EXAMINATION

Fall 2009

ECO401- Economics (Session - 3)

Time: 120 min

Marks: 87

Question No: 1 (Marks: 1) - Please choose one

If the quantity supplied of oranges exceeds the quantity demanded then:

- ▶ There is a shortage of oranges.
- ▶ **Market forces will cause the price to fall.**
- ▶ Market forces will cause the price to rise.
- ▶ The market is in equilibrium.

Question No: 2 (Marks: 1) - Please choose one
Indifference curves that are convex to the origin reflect:

- ▶ An increasing marginal rate of substitution.
- ▶ **A decreasing marginal rate of substitution.**
- ▶ A constant marginal rate of substitution.
- ▶ A marginal rate of substitution that first decreases, then increases.

Question No: 3 (Marks: 1) - Please choose one
Suppose that the price of a pizza is \$10 and price of a jeans is \$30. If ratio of marginal utility of pizza to marginal utility of jeans is 1/4 then to maximize total utility, a consumer should:

- ▶ Buy more pizzas and fewer jeans.
- ▶ **Buy fewer pizzas and more jeans.**
- ▶ Continue to buy the same quantities of pizza and jeans.
- ▶ Spend more time consuming pizza.

Question No: 4 (Marks: 1) - Please choose one
As long as all prices remain constant, an increase in money income results in:

- ▶ **An increase in the slope of the budget line.**
- ▶ A decrease in the slope of the budget line.
- ▶ An increase in the intercept of the budget line.
- ▶ A decrease in the intercept of the budget line.

Question No: 5 (Marks: 1) - Please choose one
Ali initially leased one-room space and started a small day care centre with only 4 children and one staff member. But he found that the cost per child is very high. He wants to expand the centre. Which of the following will happen when Ali expand the centre?

- ▶ Economies of scale.
- ▶ Diseconomies of scale.
- ▶ Decreasing returns to the labor inputs.
- ▶ **Increasing returns to the labor inputs.**

Question No: 6 (Marks: 1) - Please choose one
Total costs are the sum of:

- ▶ Marginal costs and variable costs.
- ▶ **Fixed costs and variable costs.**
- ▶ Fixed costs and marginal costs.
- ▶ Average variable costs and marginal costs.

Question No: 7 (Marks: 1) - Please choose one
The supply curve for a competitive firm is:

- ▶ Its entire marginal cost curve.
- ▶ The upward-sloping portion of its marginal cost curve.
- ▶ **Its marginal cost curve above the minimum point of the average variable cost**

curve.

- ▶ Its marginal cost curve above the minimum point of the average total cost curve.

Question No: 8 (Marks: 1) - Please choose one

A monopolistically competitive firm in short run equilibrium:

- ▶ Will make negative profit (lose money).
- ▶ Will make zero profit (break-even).
- ▶ Will make positive profit.
- ▶ **Any of the given are possible.**

Question No: 9 (Marks: 1) - Please choose one

The marginal revenue product is:

- ▶ Upward sloping due to the law of demand.
- ▶ Upward sloping due to the law of marginal utility.
- ▶ **Downward sloping due to the law of diminishing returns.**
- ▶ Downward sloping due to the law of supply.

Question No: 10 (Marks: 1) - Please choose one

The long run aggregate supply curve will shift to the right if:

- ▶ The price level increases.
- ▶ **Factors of production (such as labor and capital) increase.**
- ▶ Expenditures (such as consumption and net exports) increase.
- ▶ The prices of inputs used to produce goods and services (such as wages and the price of oil) decrease.

Question No: 11 (Marks: 1) - Please choose one

Keynesian economics rejected the classical assumption that:

- ▶ **Supply creates its own demand.**
- ▶ Prices and wages are inflexible.
- ▶ Self-correction takes a long time.
- ▶ Consumption expenditures depend on disposable income.

Question No: 12 (Marks: 1) - Please choose one

Final goods are meant for:

- ▶ **Direct use by the consumers.**
- ▶ Further processing.
- ▶ The term do not exist.
- ▶ None of the given options.

Question No: 13 (Marks: 1) - Please choose one

The slope of the saving function (or line) is the:

- ▶ Average propensity to save.
- ▶ Average propensity to consume.
- ▶ **Marginal propensity to save.**
- ▶ Marginal propensity to consume.

Question No: 14 (Marks: 1) - Please choose one

The investment demand curve shows the relationship between the levels of:

- ▶ Investment and consumption.
- ▶ Consumption and interest rate.
- ▶ **Investment and interest rate.**
- ▶ Investment and saving.

Question No: 15 (Marks: 1) - Please choose one

The circular flow principle guarantees that in equilibrium:

- ▶ The level of investment spending will be equal to the level of private savings.
- ▶ The level of exports will be equal to the level of imports.
- ▶ **The level of aggregate demand will be equal to real Gross Domestic Product.**
- ▶ The level of government spending will be equal to tax revenue.

Question No: 16 (Marks: 1) - Please choose one

The real interest rate will increase:

- ▶ If there is an excess supply of loanable funds in the financial markets.
- ▶ **If there is an excess demand for loanable funds in the financial markets.**
- ▶ If there is an excess supply of loanable funds in the foreign exchange markets.
- ▶ If there is an excess demand for loanable funds in the foreign exchange markets.

Question No: 17 (Marks: 1) - Please choose one

The trend of unemployment over the last forty years is:

- ▶ A decrease in unemployment.
- ▶ It has remained largely unchanged.
- ▶ **An increase in unemployment.**
- ▶ It is too difficult to tell so don't bother.

Question No: 18 (Marks: 1) - Please choose one

The Phillips curve will shift to the right:

- ▶ If there is a decrease in the expected inflation rate.
- ▶ If there is an increase in the expected inflation rate.
- ▶ If there is a decrease in the natural rate of unemployment.
- ▶ **If there is a favorable supply shock.**

Question No: 19 (Marks: 1) - Please choose one

Current account deficit is equal to:

- ▶ Private sector resource deficit.

- ▶ Government budget deficit.
- ▶ **Private sector resource deficit + Government budget deficit.**
- ▶ None of the given options.

Question No: 20 (Marks: 1) - Please choose one
Fiscal policy is the government program with respect to its:

- ▶ Steel Mill Privatization.
- ▶ Unemployment reduction.
- ▶ **Expenditure and tax revenue.**
- ▶ Increase in unemployment.

Question No: 21 (Marks: 1) - Please choose one
In Keynesian economics, an inflationary gap results if:

- ▶ Aggregate expenditures are less than aggregate production.
- ▶ **Aggregate expenditures are greater than aggregate production.**
- ▶ Aggregate expenditures are equal to aggregate production.
- ▶ There are no changes in inventories.

Question No: 22 (Marks: 1) - Please choose one
The accelerator is a related concept which formalizes the investment response to:

- ▶ **Consumption.**
- ▶ Interest rate.
- ▶ Output.
- ▶ None of the given options.

Question No: 23 (Marks: 1) - Please choose one
The principle economic difference between a competitive and a non-competitive market is:

- ▶ The number of firms in the market.
- ▶ **The extent to which any firm can influence the price of the product.**
- ▶ The size of the firms in the market.
- ▶ The annual sales made by the largest firms in the market.

Question No: 24 (Marks: 1) - Please choose one
The amount of output that a firm decides to sell has no effect on the market price in a competitive industry because:

- ▶ The market price is determined (through regulation) by the government.
- ▶ The firm supplies a different good than its rivals.
- ▶ **The firm's output is a small fraction of the entire industry's output.**
- ▶ The short run market price is determined solely by the firm's technology.

Question No: 25 (Marks: 1) - Please choose one
The concept of a risk premium applies to a person that is:

- ▶ **Risk loving.**
- ▶ Risk averse.

- ▶ Risk neutral.
- ▶ Rational.

Question No: 26 (Marks: 1) - Please choose one

Keeping in view the model of aggregate supply and aggregate demand, in the long run, an increase in the money supply should cause:

- ▶ **Both prices and output to rise.**
- ▶ Prices to fall and output to remain unchanged.
- ▶ Both prices and output to fall.
- ▶ Prices to rise and output to remain unchanged.

Question No: 27 (Marks: 1) - Please choose one

Suppose a country has flexible exchange rate and has more rapid inflation rate than other countries. What will happen to its currency in this situation?

- ▶ Its currency will appreciate.
- ▶ Its currency will depreciate.
- ▶ There will be no effect on its currency.
- ▶ **All of the given options can be possible.**

Question No: 28 (Marks: 1) - Please choose one

Which of the following statements best reflects the implication of law of comparative advantage?

- ▶ Trade between two countries is always to the advantage of both.
- ▶ **Trade between two countries can be to the advantage of both even though one may be more productively efficient at producing everything.**
- ▶ Trade between two countries is to the advantage of both if countries import only those goods that they are incapable of producing themselves.
- ▶ Trade between two countries is beneficial to both if the exporter uses less resource than the importer would use to produce the same quantity of goods.

Question No: 29 (Marks: 1) - Please choose one

Firm A produces and sells cotton to firm B for Rs. 500. Firm B makes yarn out of it and sells to firm C for Rs. 700. Firm C makes cloth and sell to consumers for Rs. 1200. Which figure has to be used for finding the economy's product?

- ▶ Rs. 500 of firm A.
- ▶ Rs. 700 of firm B.
- ▶ **Rs. 1200 of firm C.**
- ▶ Total of all three Rs. 2400.

Question No: 30 (Marks: 1) - Please choose one

The largest contribution in value terms to Pakistan GNP is made by:

- ▶ Construction sector.
- ▶ Organized industries.
- ▶ Unorganized industries.
- ▶ **Agriculture sector.**

Question No: 31 (Marks: 1) - Please choose one

National income figures are:

- ▶ Very exact.

- ▶ Practically exact.
- ▶ **Only estimates.**
- ▶ Wrong.

Question No: 32 (Marks: 1) - Please choose one

A marginal propensity to consume (MPC) of 0.95 indicates that:

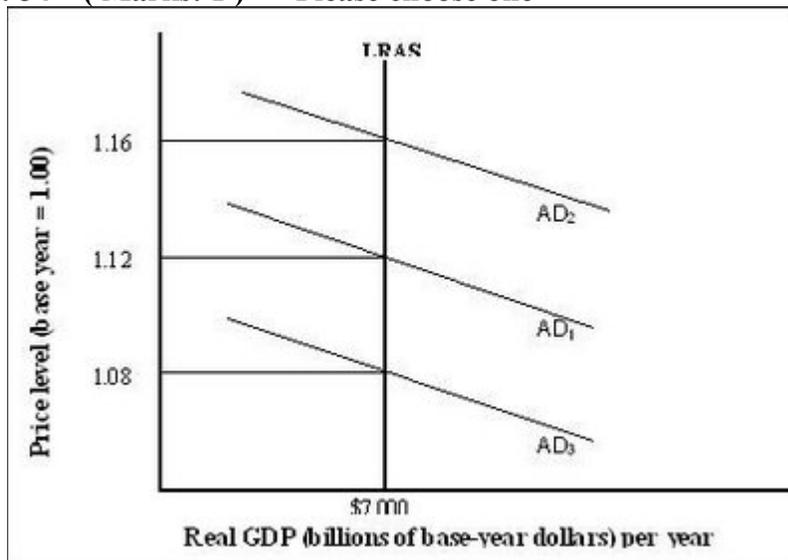
- ▶ ΔC to ΔY_d is 0.95.
- ▶ **C / Y_d is 0.95.**
- ▶ ΔY_d to ΔC is 0.95.
- ▶ Y_d / C is 0.95.

Question No: 33 (Marks: 1) - Please choose one

Which of the following describes the four sources of aggregate demand?

- ▶ Consumption, private investment, taxes, and expenditures.
- ▶ Consumption, private investment, wage increases, and government expenditures.
- ▶ Consumption, private investment, expenditures, and net exports.
- ▶ **Consumption, private investment, government purchases, and net exports.**

Question No: 34 (Marks: 1) - Please choose one



Refer to the above figure, the potential output in this economy is:

- ▶ \$7,000 billion at a price level of 1.16.
- ▶ \$7,000 billion at a price level of 1.12.
- ▶ **\$7,000 billion at a price level of 1.08.**
- ▶ All of the given options.

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Question No: 35 (Marks: 1) - Please choose one

Changes in aggregate demand can be caused by changes in:

- I. Wages.
 - II. Raw materials costs.
 - III. Government spending.
 - IV. Government regulations that increase the cost of doing business.
- ▶ I, II, III, and IV.

- ▶ I and III only.
- ▶ I, III, and IV.
- ▶ **III only.**

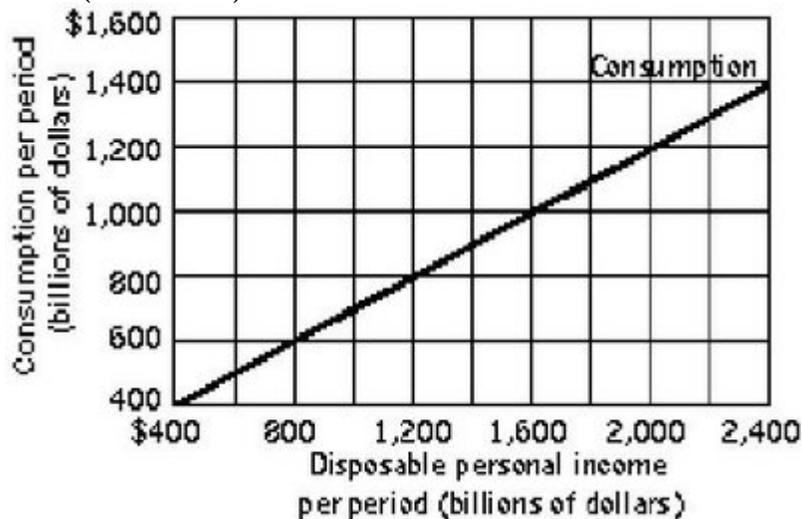
Question No: 36 (Marks: 1) - Please choose one
The short run in macroeconomic analysis is a period:

- ▶ In which wages and some other prices do not respond to changes in economic conditions.
- ▶ **In which full wage and price flexibility and market adjustment have been achieved.**
- ▶ Of less than 12 months.
- ▶ In which all macroeconomic variables are fixed.

Question No: 37 (Marks: 1) - Please choose one
Which of the following is TRUE?

- ▶ **$1 - MPS = MPC$**
- ▶ $1 + MPS = MPC$
- ▶ $1 / MPS = MPC$
- ▶ $1 \times MPS = MPC$

Question No: 38 (Marks: 1) - Please choose one



Refer to the above figure, when disposable personal income is \$1,200 billion, consumption is:

- ▶ \$600 billion.
- ▶ \$800 billion.
- ▶ \$1,200 billion.
- ▶ **\$2,000 billion.**

Question No: 39 (Marks: 1) - Please choose one

Unemployment generally ----- when the "real" GDP grows rapidly.

- ▶ Remains the same.
- ▶ Decreases.
- ▶ **Increases.**

- ▶ All of the above are possible.

Question No: 40 (Marks: 1) - Please choose one
Which of the following will influence a country's exports?

- ▶ **Consumer tastes for domestic and foreign goods.**
- ▶ Prices of goods at home and abroad.
- ▶ Costs of transporting goods from country to country.
- ▶ All of the given options.

Question No: 41 (Marks: 1) - Please choose one
Free trade is favoured because:

- ▶ Countries have less work to do.
- ▶ It leads to greater world efficiency i.e. resources are better utilized.
- ▶ **Wealthier countries gain an advantage over underdeveloped countries.**
- ▶ All countries gain from tariff imposition.

Question No: 42 (Marks: 1) - Please choose one
Devaluation is done to:

- ▶ **Encourage exports.**
- ▶ Discourage exports.
- ▶ Encourage imports.
- ▶ Encourage inflation.

Question No: 43 (Marks: 1) - Please choose one
Which of the following will happen by a reduction in net exports all other things being equal?

- ▶ It will result in a movement up along the aggregate demand curve.
- ▶ It will reduce aggregate supply.
- ▶ **It will reduce aggregate demand.**
- ▶ It will not change aggregate demand or aggregate supply in the domestic economy.

Question No: 44 (Marks: 1) - Please choose one
Which of the following is part of M1?

- I. Savings deposits.
 - II. Cash in your hand.
 - III. Checking deposits.
- ▶ I and III.
 - ▶ II and III.
 - ▶ **I only.**
 - ▶ II only.

Question No: 45 (Marks: 1) - Please choose one
Which of the following is (are) primary function (s) of a central bank?

- IV. Act as a regulator of banks.
 - V. Issue government bonds.
 - VI. Set monetary policy.
- ▶ I only.
 - ▶ I and III.
 - ▶ I and II.

► I, II and III.

Question No: 46 (Marks: 1) - Please choose one

What will be the impact of an increase of \$1 in government purchases?

- It will shift the expenditure line upward by \$1.
- It will shift the IS curve to the right by $\$1 / (1 - MPC)$.
- It will not shift the LM curve.

► All of the given options.

Question No: 47 (Marks: 1) - Please choose one

Countries that are not among the high income nations of the world are categorized as:

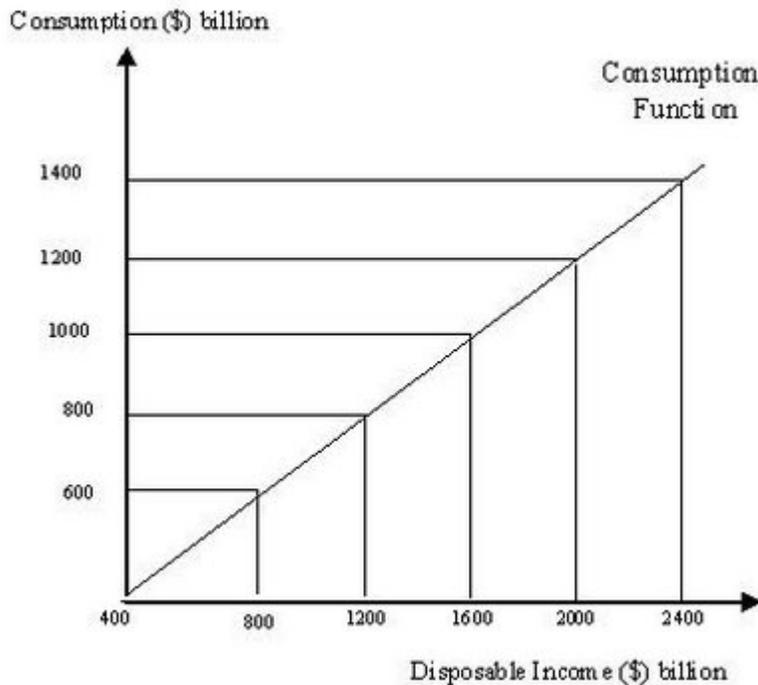
- Developed countries.
- Progressed countries.
- Developing countries.
- High income countries.

Question No: 48 (Marks: 1) - Please choose one

Which of the following is a characteristic of low income countries?

- Higher rates of population growth.
- Greater government control.
- A larger share of income used for investment.
- A smaller proportion of the labor force in agriculture.

Question No: 49 (Marks: 1) - Please choose one



Refer to the above figure, when disposable personal income is \$2,000 billion:

- Personal saving is \$1,200 billion.
- Consumption is \$1,600 billion.

▶ **Saving is \$800 billion.**

▶ Consumption is \$800 billion.

Question No: 50 (Marks: 1) - Please choose one

How many points you need to know to calculate the price elasticity of demand on the same demand curve?

▶ One.

▶ Two.

▶ **Three.**

▶ Four.

Question No: 51 (Marks: 1) - Please choose one

What is meant by the negative slope of a production possibilities curve?

▶ It means that some resources are always unemployed.

▶ **It means that an economy can produce more of one thing only by producing less of something else.**

▶ It means that opportunity costs are constant.

▶ It means that business can sell more when prices are low.

Question No: 52 (Marks: 1) - Please choose one

Which of the following will happen if the current market price is set below the market clearing level?

▶ There will be a surplus to accumulate.

▶ **There will be downward pressure on the current market price.**

▶ There will be upward pressure on the current market price.

▶ There will be lower production during the next time period.

Question No: 53 (Marks: 1) - Please choose one

For which of the following good, the substitution effect of a lowered price is counteracting by the income effect?

▶ For an inferior good.

▶ **A substitute good.**

▶ For an independent good.

▶ For a normal good.

Question No: 54 (Marks: 1) - Please choose one

Which of the following is TRUE about the marginal product of labour in any production process?

▶ It is total output divided by total labour inputs.

▶ It is total output minus the total capital stock.

▶ It is the change in total output resulting from a 'small' change on the labour input.

▶ **It is total output produced by labour inputs.**

Question No: 55 (Marks: 3)

What are the different components of aggregate demand? Discuss briefly.

Aggregate demand is the total demand for final goods and services in the economy at a given time and price level. It is the amount of goods and services in the economy that will be purchased at all possible price levels. There are four components of aggregate demand which are most important:

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1. **Consumption:** Consumption (C) is the amount of national income that is spent on goods and services produced by domestic firms in a given period of time.
2. **Investment:** Investment (I) or gross capital formation is any economic activity that forgoes consumption today with an eye to increase output in future.
3. **Net Exports:** It is net demand from rest of world for country's output.
4. **Government Spending:** These are gross investments and consumption expenditure done by government.

Question No: 56 (Marks: 5)

Explain the difference between Gross National Product (GNP) and Net National Product (NNP) with the help of their formulas.

Difference between GNP and NNP:

- GNP is the value, at current market prices, of all final goods and services produced during a year by the factors owned by the citizens of a country.

$$\text{GNP} = \text{GDP} + \text{net factor income from abroad}$$

- NNP is same application as NDP (National Domestic Product) which equal to GDP minus depreciation. Here, deprecation is amount which spends on capital goods that measure GNP. In other words, it is the net output of commodities and services flowing during the year from the country's production system in the hands of ultimate consumers.

Question No: 57 (Marks: 5)

Some economists suggest “growth through resource transfer” and “growth through stabilization and reforms” strategies to tackle the problem of poverty of under developed countries. What is the basic theme of both these strategies? Discuss.

Growth through resource transfer:

The businesses core resources transfer strategies are having close effect on customer satisfaction, production performance, and personnel expertise of the non-financial performance of business performances; but, these strategies show minor influences on the variance breadth of costs, sales performance, and development performance of business performances. For the growth of it, larger effect exists on the transfer of expertise, organizational learning, reputation and innovation of core resources. However, this strategy shows minor effect on the transfer of brand, management skills, interpersonal relationship, and management.

Growth through stabilization and reforms:

A stabilization strategy centers on addressing people's basic needs and opportunities at the local level by improving their access to basic services, by expanding economic opportunities and by promoting political/civic empowerment. Livelihood, for the purposes of this strategy, is defined as the combination of factors in a community that have a direct impact on the quality of individuals' lives. Those factors include the elements in a community that affect citizen well-being, prosperity, and future choices, such as income, health, education, security, water, small infrastructure and citizen participation.

Question No: 58 (Marks: 10)

(A) Following are the items of balance sheet of bank A

Loans = 80
Deposits = 100
Reserves = 20

Prepare the balance sheet in proper form and find out total assets and total liabilities.

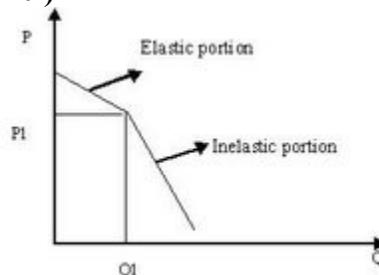
(B) Following are the items of balance sheet of bank A

Loans = 60
Deposits = 110
Reserves = 50

Firm A deposits Rs. 50 in bank A. Prepare the balance sheet in proper form and find out total assets and total liabilities after the deposits of firm A.

(Marks: 5+5)

Question No: 59 (Marks: 10)



(A) The above demand curve has two distinct segments which have different elasticities that join to form a corner or kink. Why the firms are reluctant to change the price in these two segments?

(B) What are the major advantages that an oligopoly offers for public interests?

(Marks: 5+5)

DIFFERENT SCHOOLS OF THOUGHT

(LECT. 25-27)

1 A study of how increases in the minimum wage rate will affect the national unemployment rate is an example of

- A. descriptive economics.
- B. normative economics.
- C. macroeconomics.**
- D. microeconomics.

2 Aggregate supply is the total amount

- A. of goods and services produced in an economy.**
- B. produced by the government.
- C. of products produced by a given industry.
- D. of labour supplied by all households.

3 The total demand for goods and services in an economy is known as

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- 
- A. **aggregate demand.**
B. national demand.
C. gross national product.
D. economy-wide demand.
- 4 Deflation is
A. an increase in the overall level of economic activity.
B. an increase in the overall price level.
C. a decrease in the overall level of economic activity.
D. **a decrease in the overall price level.**
- 5 A recession is
A. a period of declining prices.
B. **a period during which aggregate output declines.**
C. a period of declining unemployment.
D. a period of falling trade volumes.
- 6 Involuntary unemployment means that
A. people are not willing to work at the going wage rate.
B. **at the going wage rate, there are people who want to work but cannot find work.**
C. there are some people who will not work at the going wage rate.
D. there is excess demand in the labour market.
- 7 A cut in the income tax rate designed to encourage household consumption is an example of
A. **expansionary demand-side policy.**
B. contractionary demand-side policy.
C. expansionary supply-side policy.
D. contractionary supply-side policy.

- 8 A cut in the tax rate designed to reduce the cost of capital and hence encourage business investment is an example of
- A. expansionary demand-side policy.
 - B. contractionary demand-side policy.
 - C. **expansionary supply-side policy.**
 - D. contractionary supply-side policy.
- 9 Macroeconomics is the branch of economics that deals with
- A. **the economy as a whole.**
 - B. imperfectly competitive markets.
 - C. only the long run adjustments to equilibrium in the economy.
 - D. the functioning of individual industries and the behaviour of individual decision-making units - business firms and households.
- 10 A group of modern economists who believe that price and wage rigidities do not provide the only rationale for macroeconomic policy activism are called:
- A. **New-Keynesians.**
 - B. Keynesians.
 - C. Monetarists.
 - D. The Classical school.
- 11 Macroeconomic theory that emphasised the theories of Keynes and de-emphasised the Classical theory developed as the result of the failure of
- A. economic theory to explain the simultaneous increases in inflation and unemployment during the 1970s.
 - B. fine tuning during the 1960s.
 - C. the economy to grow at a rapid rate during the 1950s.
 - D. **the Classical model to explain the prolonged existence of high unemployment during the Great Depression.**
- 12 Keynes believed falling wages were not a solution to persistent unemployment because
- A. falling wages demoralised workers.
 - B. **this would reduce the purchasing power of labourers as consumers. This in turn would weaken firms' prospects of selling more goods, hence inducing them to cut their investment (and hence labour) demand.**
 - C. the unemployment was caused by frictional and structural factors.
 - D. wages would fall more than required to clear the labour market.
- 13 The practice of using fiscal and monetary policy to stabilise the economy is known as
- A. **fine tuning of demand**
 - B. monetarism
 - C. laissez faire economics
 - D. supply side economics
- 14 According to Classical models, the level of employment is determined primarily by
- A. interest rates.
 - B. the level of prices.
 - C. **the level of aggregate supply in the economy**

- D. the level of aggregate demand for goods and services.
- 15 According to Keynes, the level of employment is determined by
- A. interest rates.
 - B. the level of prices.
 - C. the level of aggregate supply in the economy
 - D. the level of aggregate demand for goods and services.**
- 16 According to the Classical model, unemployment
- A. could not persist because wages would fall to eliminate the excess supply of labour.**
 - B. could persist for long periods of time because wages are not flexible.
 - C. could be eliminated only through government intervention.
 - D. could never exist.
- 17 To get the economy out of a slump, Keynes believed that the government should
- A. increase both taxes and government spending.
 - B. increase taxes and/or decrease government spending.
 - C. cut both taxes and government spending.
 - D. decrease taxes and/or increase government spending.**
- 18 Aggregate demand refers to the **total demand** for all domestically produced goods and services in an economy **generated from**
- A. the household and government sectors.
 - B. the household sector.
 - C. all sectors except the rest of the world.
 - D. all sectors including the rest of the world.**
- 19 Government policies that focus on increasing production rather than demand are called:
- A. fiscal policies.
 - B. monetary policies.
 - C. incomes policies.
 - D. supply-side policies.**
- 20 Prices that do not always adjust rapidly to maintain equality between quantity supplied and quantity demanded are
- A. market prices.
 - B. sticky prices.**
 - C. fixed prices.
 - D. regulatory prices.
- 21 The economists who emphasised wage-flexibility as a solution for unemployment were
- A. Monetarists.
 - B. New-Keynesians.
 - C. Classical economists.**
 - D. Keynesians.
- 22 According to the Classical economists, the economy

- 
- A. requires fine tuning to reach full employment.
 - B. should not be left to market forces.
 - C. will never be at full employment.
 - D. is self correcting.**

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23 Monetarism became popular because it was able to, unlike Classical or Keynesian economics, explain

- A. stagflation in the late 1970s.**
- B. demand-pull inflation in the 1960s.
- C. low growth rates in the 1950s.
- D. the prolonged existence of high unemployment during the Great Depression.

- 24 Keynes' explanation for low firm investment during the Great Depression was
- A. low savings, which placed a constraint on investment
 - B. high real borrowing rates, which discouraged firm borrowing
 - C. high savings, which left consumers with less money to spend on goods and serviced produced by firms**
 - D. A permanent change in Europe's corporate ownership structures.
- 25 Rapid increases in the price level during periods of recession or high unemployment are known as
- A. slump.
 - B. stagnation.**
 - C. stagflation.
 - D. inflation.
- 26 The hypothesis that people know the 'true model' of the economy and that they use this model and all available information to form their expectations of the future is the
- A. rational-expectations hypothesis.**
 - B. active-expectations hypothesis.
 - C. static-expectations hypothesis.
 - D. adaptive-expectations hypothesis.
- 27 Neo-Classical theories were an attempt to explain
- A. how unemployment could have persisted for so long during the Great Depression.
 - B. the stagflation of the 1970s.**
 - C. why policy changes that are perceived as permanent have more of an impact on a person's behaviour than policy changes that are viewed as temporary.
 - D. the increase in the growth rate of real output in the 1950s.
- 28 A group of modern economists who believe that markets clear very rapidly and that expanding the money supply will always increase prices rather than employment are the
- A. New-Keynesians.
 - B. Keynesians.
 - C. Monetarists.**
 - D. The Classical school.
- 29 Say's law states that:
- A. Supply creates its own demand.**
 - B. Demand creates its own supply.
 - C. There is no such things as a free lunch
 - D. Macroeconomic policy activism is essential to ensure full-employment.
- 30 The aggregate supply (AS) curve and aggregate demand (AD) curve in a realistic Keynesian world are:
- A. AS: fully horizontal; AD: downward sloping
 - B. AS: horizontal only till the full capacity level; AD: downward sloping**
 - C. AS: vertical; AD: upward sloping
 - D. AS: horizontal; AD: vertical

Total Marks = 10

Highlight the correct option.

1. A price taker is:

- A. A firm that accepts different prices from different customers.
- B. A consumer who accepts different prices from different firms.
- C. A firm that cannot influence the market price.**
- D. Both (b.) and (c.).

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2. Which of following is a key assumption of a perfectly competitive market?

- A. Firms can influence market price.
- B. Commodities have few sellers.
- C. It is difficult for new sellers to enter the market.
- D. Each seller has a very small share of the market.**

3. A firm maximizes profit by operating at the level of output where:

- A. Average revenue equals average cost.
- B. Average revenue equals average variable cost.
- C. Total costs are minimized.
- D. Marginal revenue equals marginal cost.**

4. The demand curve facing a perfectly competitive firm is:

- A. Downward-sloping and less flat than the market demand curve.
- B. Downward-sloping and more flat than the market demand curve.
- C. Perfectly horizontal.**
- D. Perfectly vertical.

5. Compared to the equilibrium price and quantity sold in a competitive market, a monopolist will charge a _____ price and sell a _____ quantity:

- A. Higher; larger

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- B. Lower; larger
- C. Higher; smaller**
- D. Lower; smaller

6. The monopolist has no supply curve because:

- A. The quantity supplied at any particular price depends on the monopolist's demand curve.**
- B. The monopolist's marginal cost curve changes considerably over time.
- C. The relationship between price and quantity depends on both marginal cost and average cost.
- D. There is a single seller in the market.

7. A doctor sizes up patients' income and charges wealthy patients more than poorer ones. This pricing scheme represents a form of:

- A. First-degree price discrimination.
- B. Second-degree price discrimination.
- C. Third-degree price discrimination.**
- D. Pricing at each consumer's reservation price.

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8. For which of the following market structures is it assumed that there are barriers to entry?

- A. Perfect competition
- B. Monopolistic competition
- C. Monopoly**
- D. All of the above

9. A market with few entry barriers and with many firms that sell differentiated products is:

- A. Purely competitive.
- B. A monopoly.
- C. Monopolistically competitive.**
- D. Oligopolistic.

10. Which of the following does not refer to macroeconomics?

- A. The study of aggregate level of economic activity.
- B. The study of causes of unemployment.
- C. The study of causes of inflation.
- D. The study of the economic behavior of individual decision-making units such as consumers, resource owners and business firms.**

Assignment # 1

ECO401

Total marks = 10

Highlight the correct option.

1. The study of economics is primarily concerned with:

- A. Demonstrating that capitalistic economies are superior to socialistic economies.
- B. Determining the most equitable distribution of society's output.
- C. Keeping private businesses from losing money.
- D. Choices which are made in seeking to use scarce resources efficiently.**

2. Opportunity cost is:

- A. That which we forego, or give up, when we make a choice or a decision.**
- B. A cost that cannot be avoided, regardless of what is done in the future.
- C. The additional cost of producing an additional unit of output.
- D. The additional cost of buying an additional unit of a product.

3. Periods of less than full employment correspond to:

- A. Points outside the ppf.(production possibility frontier).
- B. Points inside the ppf.**
- C. Points on the ppf.
- D. Either points inside or outside the ppf.

4. In a free-market economy the allocation of resources is determined by:

- A. votes taken by consumers
- B. a central planning authority
- C. Consumer preferences**
- D. the level of profits of firms

5. A firm produces chairs. An economist working for the firm predicts that 'if people's incomes rise next year, then the demand for our chairs will increase, ceteris paribus.' The accuracy of the economist's prediction depends on whether the chairs that firm produces:

- A. Have many complementary goods.
- B. Have few substitutes.
- C. Have few complementary goods.
- D. **Are normal goods.**

6. According to law of demand, a demand curve is:

- A. Horizontal
- B. Vertical
- C. **Downward sloping**
- D. Directly related to law of supply

7. A rational decision maker will take only those actions for which the marginal benefit:

- A. Is positive.
- B. Is at its maximum level.
- C. Is less than marginal cost.
- D. **Is greater than or equal to the expected marginal cost.**

8. All of the following are determinants of supply except:

- A. Price
- B. **Income levels**
- C. Objectives of the firm
- D. Level of technology

9. Normative economics:

- A. Deals solely with the facts
- B. Is never studied in the colleges
- C. **Involves opinions and interpretations**
- D. Is clearly preferable to positive economics

10. The transformation of resources into economic goods and services is:

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- A. Technical efficiency
- B. Input
- C. Production**
- D. Increasing returns

Solution of Quiz # 2

ECO401

Total Marks: 10

Highlight the correct option.

1. The price elasticity of demand is defined as the absolute value of the ratio of:

- A. Price over quantity demanded.
- B. Change in price over change in quantity demanded.
- C. Percentage change in price over the percentage change in quantity demanded.
- D. Percentage change in quantity demanded over the percentage change in price.**

2. If a good is a luxury, its income elasticity of demand is:

- A. positive and less than 1
- B. negative but greater than -1
- C. positive and greater than 1**
- D. zero

3. A resource is something that:

- A. Is used to produce goods and services.**
- B. Is provided by nature, not made by society.
- C. Exists in unlimited quantities.
- D. Must be produced by a firm.

4. If the cross-price elasticity between home personal computers and video game units for TV is positive, one can conclude that

- A. These products are substitutes for one another.**
- B. These products complement one another.
- C. These products are over-priced.
- D. Consumers are irrational.

5. As one moves along a convex isoquant, which of the following does not change?

- A. The marginal rate of technical substitution.
- B. The capital-labor ratio.
- C. The marginal product of labor relative to the marginal product of capital.
- D. The level output produced.**

6. Of the following goods, the one where the law of diminishing marginal utility is least likely to apply is:

- A. Water.
- B. Cigarettes.**
- C. Toothpaste.
- D. Rap music.

7. The optimal purchasing rule states that total utility is maximized when a consumer:

- A. Consumes as much as possible of all good.
- B. Consumes the same quantities of all goods.
- C. Completely uses up their income.
- D. Consumes to the point where the marginal utility per dollar spent on all goods is the same.**

8. Which of the following pairs come closest to being complementary goods?

- A. Apples and oranges.
- B. Cameras and films.**
- C. A free hotel room and a free meal.
- D. Cream and milk.

9. A Giffen good:

- A. Is a good that people buy more of as their incomes fall.
- B. Is a good which people buy more of as its price increases.**
- C. Is a good on which people spend a small portion of their income.
- D. Has a vertical demand curve.

10. When an industry expands its costs of production will:

- A. Increase.**
- B. Decrease.
- C. stay the same.

D. none of the above.

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Total Marks = 10

Highlight the correct option:

1. Disposable Income is obtained by subtracting _____ taxes from personal income:

- A. Indirect Taxes
- B. Direct Taxes**
- C. Subsidies
- D. None

2. Per capita income is obtained by dividing National Income by:

- A. Total labor Force in the Country
- B. Unemployed Youth in the Country
- C. Total population of that country.**
- D. None

3. The investment demand curve shows the relationship between the levels of:

- A. Investment and Consumption
- B. Consumption and Interest Rate
- C. Investment and Interest Rate**
- D. None

4. The situation in which the imports are greater than exports is termed as:

- A. Trade Surplus
- B. Trade Deficit**
- C. Budget Surplus
- D. None

5. Fiscal policy is the government programme with respect to it's:

- A. Steel Mill Privatization
- B. Unemployment Reduction
- C. Expenditure and Tax revenue**
- D. None

6. Imports for any economy are considered as:

- A. Injections
- B. Leakages**
- C. Brain Drain
- D. None

7. The accelerator is a related concept which formalizes the investment response to:

- A. Consumption
- B. Interest rate
- C. Output**
- D. None

8. According to Keynes macroeconomic equilibrium is attained when:

- A. Prime Minister is PhD in Macroeconomics
- B. Aggregate Demand Equals Aggregate Supply**
- C. Inflation Exists in Economy.
- D. None

9. There are _____ methods of measuring GDP:

- A. Four
- B. Three**
- C. Five
- D. None

10. Intermediate goods are meant for:

- A. Direct use by the consumers
- B. further processing**
- C. The term do not exist
- D. None

Solution of Assignment # 2(Special 2006) ECO401

Assignment Question:

If

$$TR = 100q - 4q^2$$

$$TC = 50 + 20q$$

Find out the value of output at which profit is maximized.

Solution:

Profit is maximized at the point where

$$\mathbf{MC = MR}$$

MC function can be found by taking derivative of total cost function. i.e.:

$$MC = d TC / dQ$$

$$MC = 20$$

MR function can be found by taking derivative of total revenue (TR) function i.e.:

$$MR = d TR / dQ$$

$$= 100 - 8Q$$

As profit is maximized at the point where $MR = MC$, so by equating values of MC and MR function, we get,

$$\mathbf{MR = MC}$$

$$100 - 8Q = 20$$

$$8Q = 100 - 20$$

$$8Q = 80$$

$$\mathbf{Q = 10}$$

The equation for total profit is,

$$T\pi = TR - TC$$

$$= 100Q - 4Q^2 - (50 + 20Q)$$

$$= 100Q - 4Q^2 - 50 - 20Q$$

$$= -4Q^2 + 80Q - 50$$

Putting $Q = 10$, we get,

$$T\pi = -4(10)^2 + 80(10) - 50$$

$$= -400 + 800 - 50$$

$$\mathbf{T\pi = 350}$$

So profit is maximized where output is 10 and the maximum profit is 350.

ASSIGNMENT 8
MACROECONOMIC DATA AND VARIABLES, NATIONAL INCOME
ACCOUNTING AND EQUILIBRIUM IN A KEYNESIAN ECONOMY
(LECT. 28-32)

Questions 1-3 are based on the following information about an economy:

Consumer price index (2002) = 132
Consumer price index (2001) = 110
Nominal GDP (2002) = \$60bn
Nominal GDP (2001) = \$50bn
Population (2002) = 7mn
Population (2001) = 6mn
Net factor income from abroad (2002) = +\$3bn
Net factor income from abroad (2001) = -\$2bn

1. By how much has real GDP grown from 2001 to 2002?
 - A. -10%
 - B. 12.5%
 - C. 20%
 - D. 0%**

2. By how much has per capita nominal GNP changed from 2001 to 2002?
 - A. -10%
 - B. 12.5%**
 - C. 20%
 - D. 0%

3. Based on the above information, we can say that:
 - A. Poverty has fallen in the country
 - B. Per capita real GDP is falling**
 - C. Income inequality has worsened
 - D. Real growth in the informal sector is 0%

4. In the circular flow of income, Keynesian equilibrium obtains when
 - A. All the individual sectors are in equilibrium: $S=I$, $T=G$, $M=X$
 - B. The aggregate injections equal aggregate withdrawals $S+T+M = I+G+X$**
 - C. There is no inflation or unemployment
 - D. The interest rate and exchange rate are at their market clearing levels

5. Under conditions of Keynesian equilibrium:
 - A. aggregate demand equals aggregate supply
 - B. aggregate demand equals national income
 - C. both A and B**

- D. none of the above
6. Which of the following is a determinant of consumption
- A. expectations about future prices
 - B. level of indebtedness of consumers
 - C. the price level
 - D. all of the above**
7. Which is the most volatile component of aggregate demand
- A. Net exports
 - B. consumption
 - C. investment**
 - D. government spending
8. Which of the following is not an obvious or direct determinant of a country's imports
- A. real exchange rate
 - B. income
 - C. tariff rates
 - D. interest rate**
9. When consumption is 650, income is 750; when consumption is 620, income is 700. Assuming there is no government, $I=100$, net exports are 10, what is the level of equilibrium income?
- A. 500
 - B. 625
 - C. 775**
 - D. 850
10. Which of the following is not true?
- A. Starting from no growth, a positive output growth rate would be associated with even higher rates of investment (the accelerator effect)
 - B. Higher investment causes a multiplied increase in income
 - C. Such increases in income would continue to induce higher investment, which in turn would continue to cause multiplied increases in output.
 - D. All of the above.**
11. In the equation $C = a + bY$, which describes the aggregate consumption function, 'a' stands for
- A. the amount of consumption when income is zero.**
 - B. the marginal propensity to consume.
 - C. the amount of consumption when income is Maximum.
 - D. the average consumption level.
12. Total consumption divided by total income gives us:
- A. the average propensity to consume.**
 - B. the marginal propensity to save.
 - C. the marginal propensity of expenditure.
 - D. the marginal propensity to consume.
13. Disposable income is the part of households' income left after the deduction of

- A. pension contributions.
B. income tax and social security payments.
C. income tax.
D. savings.
14. As the MPS increases, the multiplier will
- A. increase.
B. either increase or decrease depending on the size of the change in investment.
C. remain constant.
D. decrease.
15. In macroeconomics, equilibrium is defined as that point at which
- A. **planned aggregate expenditure equals aggregate output.**
B. planned aggregate expenditure equals consumption.
C. aggregate output equals consumption minus investment.
D. saving equals consumption.
16. The ratio of the change in the equilibrium level of output to a change in some autonomous component of aggregate demand is the
- A. elasticity coefficient.
B. multiplier.
C. marginal propensity of the autonomous variable.
D. automatic stabiliser.
17. Assuming there are no taxes (and no foreign sector), if the MPC is .8, the multiplier is
- A. 2.5.
B. 8.
C. 5.
D. 2.
18. Assuming the net income tax rate is 25% (and there is no foreign sector), if the MPC is 0.8, the multiplier is
- A. **2.5.**
B. 8.
C. 5.
D. 2.
19. Assuming there is no foreign sector, if the multiplier is 3, and the net income tax rate is 20%, the MPC is
- A. 3/4
B. 4/5
C. 5/6
D. 6/7
20. Assume there is no government or foreign sector. If the MPC is .75, a Rs.20 billion decrease in planned investment will cause aggregate output to decrease by
- A. Rs. 80 billion.**

- B. Rs. 20 billion.
C. Rs. 26.67 billion.
D. Rs. 15 billion.
21. According to the 'paradox of thrift,' increased efforts to save will cause
A. an increase in income and an increase in overall saving.
B. a decrease in income and an overall decrease in saving.
C. a decrease in income but an increase in saving.
D. an increase in income but no overall change in saving.
22. If injections are less than withdrawals at the full-employment level of national income, there is
A. an inflationary gap.
B. equilibrium.
C. a deflationary gap.
D. hyperinflation.
23. The accelerator theory of investment says that induced investment is determined by
A. the rate of change of national income.
B. expectations.
C. the level of national income.
D. the level of aggregate demand.
24. The diagram that shows the money received and paid out by each sector of the economy is the
A. income-price diagram.
B. income-expenditures diagram.
C. circular flow diagram.
D. aggregate demand-aggregate supply diagram.

ASSIGNMENT 09

THE BIG FOUR: UNEMPLOYMENT, INFLATION, BALANCE OF PAYMENTS AND GROWTH (LECT. 33-39)

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UNEMPLOYMENT

1. If both the no. of unemployed people and the size of the labour force increase by 10,000, then
A. the unemployment rate will remain the same.
B. the unemployment rate will increase.
C. the unemployment rate will decrease.
D. we cannot tell.
2. Which of the following could be a reason for the problem of “lack of jobs” being overestimated:
A. the existence of disguised unemployment
B. people are underemployment

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- C. people holding only one job (as opposed to multiple jobs)
- D. the existence of child labour**

3. Which of the following is not a cost of voluntary unemployment?

- A. potential output of the economy is greater than actual output
- B. government loses tax revenue
- C. firms lose (potential) revenues due to operating below capacity
- D. mental stress undergone by the unemployed persons**

4. “Because higher wages are less likely to induce people who are structurally or physically unable to participate on the labour force. On the other hand people already on the labour force are more likely to respond to higher wages by accepting jobs.”

The above statement is an answer to which question?

- A. Why is the AJ curve more elastic than the LF curve**
- B. Why is the LF curve not totally vertical
- C. Why is the AJ curve not completely vertical
- D. Why is it difficult to completely remove the horizontal distance between the AJ and LF curves

5. Which of the following would constitute sound government policy if you subscribed to the Monetarist view on unemployment?

- A. increase aggregate demand through monetary or fiscal policy
- B. reduce the obstacles to downward wage rigidity (like unions, unemployment benefits, minimum wage legislations etc.)
- C. Reduce the marginal income tax rate (to increase the incentive to work)**
- D. All of the the above

6. The persistence of a phenomenon, such as unemployment, even when its causes have been removed is called

- A. The paradox of thrift.
- B. hysteresis.**
- C. structural unemployment.
- D. ceteris paribus.

7. Cyclical unemployment is the

- A. portion of unemployment that is due to changes in the structure of the economy that result in a significant loss of jobs in certain industries.
- B. unemployment that results when people become discouraged about their chances of finding a job so they stop looking for work.
- C. portion of unemployment that is due to seasonal factors.
- D. unemployment that occurs during recessions and depressions.**

8. The natural rate of unemployment is generally thought of as the

- A. ratio of the frictional unemployment rate to the cyclical unemployment rate.

- B. sum of frictional unemployment and cyclical unemployment.
C. **sum of frictional unemployment and structural unemployment.**
D. sum of structural unemployment and cyclical unemployment.
9. One of the tenets of the Classical view of the labour market is that the wage adjustments that are necessary to clear the labour market occur
- A. slowly.
B. instantly.
C. very infrequently.
D. **very quickly.**
10. According to Keynesian economists, those who are not working
- A. have given up looking for a job, but would accept a job at the current wage if one were offered to them.
B. are too productive to be hired at the current wage.
C. have chosen not to work at the market wage.
D. **are unable to find a job at the current wage rate.**

INFLATION

11. The index used most often to measure inflation is the
- A. **consumer price index.**
B. wholesale price index.
C. student price index.
D. producer price index.
12. If you were the owner of a cycle manufacturing firm, would you be particularly worried if wage inflation were higher than price inflation?
- A. No. Because you would still be able to sell your goods at the higher price.
B. **Yes. Because the cost of your input is growing faster than the revenue obtained from your output**
C. Yes. Because both price and wage inflation are bad.
D. No. Because any loss to the firm will be offset by the gain to the workers.
13. Which of the following is not a major cost of inflation:
- A. Resource wastage: as people spend time and money to guard against the “purchasing power erosion” effects of inflation, while firms suffer menu costs (i.e. the costs of frequently issuing “revised” price lists).
B. Uncertainty: firms defer investment when inflation is high and volatile as the latter complicates predicting future cashflows.
C. Worsened income inequality: inflation is a regressive tax on the people that does not take into account the taxpayers’ “ability to pay”. As such, there is a redistribution of wealth from the poor to the rich.
D. **Money printing costs: inflation requires more currency notes to be printed and this raises the government’s printing costs.**
14. In the long run, the Phillips curve will be vertical at the natural rate of

unemployment if

- A. the long-run supply curve is horizontal at the natural rate of inflation.
 - B. the long-run aggregate demand curve is vertical at potential GDP.
 - C. the long-run aggregate demand curve is horizontal at the natural rate of inflation.
 - D. the long-run aggregate supply curve is vertical at potential GDP.**
15. According to the monetarists, the measured unemployment rate can
- A. be reduced below the natural rate only in the short run, and not without inflation.**
 - B. be reduced below the natural rate only in the long run, and only if the price level is constant.
 - C. be reduced below the natural rate only in the short run, and only if the price level is constant.
 - D. be reduced below the natural rate only in the long run, and not without inflation.
16. If the prices of all inputs seem to be rising, can you be absolutely sure that it is cost-push inflation?
- A. No, because cost-push inflation is caused by an increase in the cost of only one input.
 - B. Yes, because that is exactly the definition of cost-push inflation.
 - C. No, because such a situation can also be caused by particular demand pressures in the economy.**
 - D. Yes, because this is exactly what happens in stagflation.
17. The quantity theory of money implies that, provided velocity of money is constant, a given percentage change in the money supply will cause
- A. an equal percentage change in nominal GDP.**
 - B. a larger percentage change in nominal GDP.
 - C. an equal percentage change in real GDP.
 - D. a smaller percentage change in nominal GDP.
18. If input prices adjusted very slowly to output prices, the Phillips curve would be
- A. downward sloping.
 - B. vertical or nearly vertical.
 - C. upward sloping.
 - D. horizontal or nearly horizontal.**
19. If inflationary expectations increase, the short-run Phillips curve will
- A. become vertical.
 - B. become upward sloping.
 - C. shift to the right.**
 - D. shift to the left.

BALANCE OF PAYMENTS

20. The record of a country's transactions in goods, services, and assets with the rest of the world is its _____; while the difference between a country's merchandise exports and its merchandise imports is the _____.

- A. current account; trade balance.
- B. capital account; balance of payments.
- C. balance of trade; capital account.
- D. balance of payments; balance of trade.**

21. Assuming there is no government intervention in the foreign exchange market, which of the following statements must clearly be FALSE, given that?

- A. If the capital account is in surplus, then the current account is likely to be in deficit.
- B. If the current account is in deficit, then the capital account is likely to be in surplus.
- C. If the current account is in balance, the capital account is also likely to be in balance.
- D. None of the above.**

22. Which of the following statements is necessarily TRUE?

- A. A country runs a current account deficit if it imports more goods and services than it exports.
- B. The sum of the current and capital accounts must be zero.
- C. If both the current and capital accounts are in surplus, the exchange rate must appreciate.
- D. None of the above.**

23. All currencies other than the domestic currency of a given country are referred to as

- A. reserve currencies.
- B. near monies.
- C. foreign exchange.**
- D. hard currency.

24. Exchange rates that are determined by the unregulated forces of supply and demand are

- A. floating exchange rates.**
- B. pegged exchange rates.
- C. fixed exchange rates.
- D. managed exchange rates.

25. If the State Bank of Pakistan reduces the money supply, a floating exchange rate will help in reducing inflation because

- A. as the money supply is decreased, the interest rate will increase, and the price of both Pakistani exports and Pakistani imports will rise.
- B. as the money supply is decreased, the interest rate will increase, and the price of Pakistani exports will rise and the price of Pakistani imports will fall.
- C. as the money supply is decreased, the interest rate will increase, and the price of Pakistani exports will fall and the price of Pakistani imports will rise.**
- D. as the money supply is decreased, the interest rate will increase, and the price of Pakistani exports and Pakistani imports will fall.

26. The fall (rise) in value of one currency relative to another is

- A. a floating (fixing) of the currency.
- B. an appreciation (depreciation) of a currency.**

- C. a depreciation (appreciation) of a currency.
- D. a strengthening (weakening) of a currency.

27. If purchasing power parity prevails absolutely in a two country world, the real exchange rate between the two countries should be:

- A. **1.**
- B. constantly changing.
- C. relatively stable, but not constant
- D. none of the above

28. The interest parity equation implies that there is a general tendency for:

- A. exchange rates to be insensitive to the differential rates of interest between countries.
- B. **the currencies of relatively low-interest countries to appreciate.**
- C. the currencies of relatively high-interest countries to appreciate.
- D. the currencies of relatively low-interest countries to depreciate.

Note that currencies with low rates of interest also typically have low inflation rates. This follows from the Fischer equation which maintains that the nominal interest rate = real interest rate + expected inflation.

29. Which of the following is (are) correct statement(s) about the current account deficit?

- A. A current account deficit is bad, if it is being caused by excessive consumer spending
- B. A current account deficit is bad, if it is fuelled by high fiscal deficits
- C. A current account deficit is good, if it is caused by the excess of productive domestic investment over domestic savings
- D. **All of the above**

30. The J-curve effect refers to the observation that

- A. GDP usually decreases before it increases after a currency depreciation.
- B. GDP usually decreases before it increases after a currency appreciation.
- C. the trade balance usually gets worse before it improves after a currency appreciation.
- D. **the trade balance usually gets worse before it improves after a currency depreciation.**

31. If Japan exports more direct investment capital abroad than expected, then the yen will tend to

- A. appreciate.
- B. fluctuate more than if exports were lower.
- C. **depreciate.**
- D. not be affected.

32. Today is Tuesday morning. If currency dealers expect the value of the dollar to fall by 10% on Wednesday, then, ceteris paribus, what will happen by the end of today to the Rs./dollar exchange rate? It will:

- A. Rise by more than 10%.

- B. Rise by exactly 10%.
- C. Fall by less than 10%.
- D. Remain constant.

Hint: Use your common sense. Think of “yourself” as a currency trader and then answer the question, based on your future expectation and the incentive it creates.

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GROWTH

33. According to traditional thinking on the subject, which of the following would not generate economic growth in an economy?

- A. an increase in the size of the labour force.
- B. an increase in the productivity of capital.
- C. a move to more capital intensive production methods**
- D. discovery of a major mineral resource in the country

34. When referring to economic growth, we normally refer to:

- A. growth in actual real per capita output**
- B. growth in potential real per capita output
- C. growth in actual nominal per capita output
- D. growth in potential real per capita output

35. A variable whose value is determined by the model of which it is a part is termed _____.

- A. endogenous**
- B. exogenous
- C. independent
- D. constant

36. An example of capital deepening, given an increasing L, would be:

- A. K increases so as to maintain a constant K/L
- B. K increases so much that K/L increases**
- C. K remains constant so that L/K increases
- D. K falls, so as to reduce K/L

37. The neo-classical growth model says that:

- A. poor countries should catch-up (or converge to) with richer countries
- B. higher savings (or rates of capital accumulation) cannot raise a country's steady state growth rate
- C. the steady state growth rate of real output depends on the sum of the (exogenous) growth rates in population and technical progress.
- D. All of the above.**

RELATIONSHIPS BETWEEN THE BIG FOUR

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38. The length of a business cycle would be measured from
- A. peak to trough.
 - B. trough to peak.
 - C. peak to peak.**
 - D. the slump to the expansion.
39. If the economy is in the expansionary phase of the business cycle, aggregate demand is likely to be _____, unemployment is likely to be _____, inflation is likely to be _____, and the current account of the balance of payments is likely to be moving towards _____.
- A. rising; falling; rising; deficit**
 - B. static; low; rising; deficit
 - C. falling; falling; falling; surplus
 - D. falling; rising; falling; surplus
40. If the economy is at the peak of the business cycle, aggregate demand is likely to be _____, unemployment is likely to be _____, inflation is likely to be _____, and the current account of the balance of payments is likely to be moving towards _____.
- A. rising; falling; rising; deficit
 - B. static; low; rising; deficit**
 - C. falling; falling; falling; surplus
 - D. falling; rising; falling; surplus
41. If the economy is approaching the trough phase of the business cycle, aggregate demand is likely to be _____, unemployment is likely to be _____, inflation is likely to be _____, and the current account of the balance of payments is likely to be moving towards _____.
- A. rising; falling; rising; deficit
 - B. static; low; rising; deficit
 - C. falling; falling; falling; surplus
 - D. falling; rising; falling; surplus**
42. Which of the following is not true regarding the effects of growth on the balance of payments and vice versa?
- A. Generally, growth raises incomes which will translate into higher consumption and higher imports, causing the current account of the BOPs to deteriorate.
 - B. If growth is “export-led”, it will boost the current account surplus of the BOPs.
 - C. If the current account deficit reflects an underlying private sector resource deficit, it is likely to be bad for future growth.**
 - D. If the current account reflects rising imports of military equipment by the government, it might not be beneficial for economic growth.
43. A country has high inflation and is running a current account deficit. What should it do in the context of the Salter-Swan diagram?
- A. Reduce government spending and revalue the exchange rate
 - B. Increase government spending and devalue the exchange rate
 - C. Reduce the money supply and devalue the exchange rate**
 - D. Increase government spending and revalue the exchange rate

1) ----- is the entire satisfaction one derives from consuming goods or services:

- A. Total utility
- B. Scarcity
- C. Marginal utility
- D. Rationing

2) The law of diminishing marginal utility states that:

- A. As consumer consumes more and more units of any commodity, the utility that consumer derives from each additional unit falls
- B. As consumer consumes more and more units of any commodity, the utility that consumer derives from each additional unit rises
- C. As consumer consumes more and more units of any commodity, the utility that consumer derives from each additional unit remains the same
- D. As consumer consumes less and less units of any commodity, the utility that consumer derives from each additional unit falls

3) The equi marginal principle states that:

A. $\frac{MU_a}{P_a} = \frac{MU_b}{P_b} = \frac{MU_c}{P_c} = \dots = \frac{MU_n}{P_n}$

B. $\frac{MU_a}{P_a} > \frac{MU_b}{P_b} > \frac{MU_c}{P_c} > \dots > \frac{MU_n}{P_n}$

C. $\frac{MU_a}{P_a} < \frac{MU_b}{P_b} < \frac{MU_c}{P_c} < \dots < \frac{MU_n}{P_n}$

D. None of the given options

4) Marginal utility measures:

- A. The slope of the indifference curve
- B. The additional satisfaction from consuming one more unit of a good
- C. The slope of the budget line
- D. The marginal rate of substitution

5) ----- is the difference between willingness to pay and what the consumer actually has to pay:

- A. Total Utility
- B. Consumer surplus
- C. Producer surplus
- D. Total product

6) ----- is the ratio of the probability of success to the probability of failure:

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- A. Input output ratio
- B. Odds ratio**
- C. Price earning ratio
- D. Price sales ratio

7) ----- operate under the principle of law of large numbers:

- A. Banks
- B. Insurance companies**
- C. Government sponsored enterprises
- D. None of the given options

8) The optimum consumption point for the consumer is a point where:

- A. The slopes of the indifference curve and budget line are equal**
- B. The slopes of the indifference curve and total product are equal
- C. The slopes of the total utility curve and budget line are equal
- D. The slopes of the total product curve and total utility curve are equal

9) A curve that represents all combinations of market baskets that provide the same level of utility to a consumer is called:

- A. A budget line
- B. An isoquant
- C. An indifference curve**
- D. A demand curve

10) The slope of an indifference curve reveals that:

- A. The preferences are complete
- B. The marginal rate of substitution of one good for another good**
- C. The ratio of market prices
- D. That preferences are transitive

11) The law of diminishing returns applies to

- A. The short run only**
- B. The long run only
- C. Both the short and the long run
- D. Neither the short nor the long run

12) In the long run:

- A. All inputs are fixed
- B. All inputs are variable**
- C. At least one input is variable and one input is fixed
- D. At most one input is variable and one input is fixed

13) According to the law of diminishing returns

- A. The total product of an input will eventually be negative
- B. The total product of an input will eventually decline
- C. The marginal product of an input will eventually be negative
- D. The marginal product of an input will eventually decline**

14) The slope of the total product curve is the

- A. Average product
 - B. Slope of a line from the origin to the point
 - C. Marginal product**
 - D. Marginal rate of technical substitution
- <http://vustudents.ning.com/>

15) The short run is

- A. Less than a year
- B. Three years
- C. However long it takes to produce the planned output
- D. A time period in which at least one input is fixed**

16) The marginal product of an input is

- A. Total product divided by the amount of the input used to produce this amount of output
- B. The addition to total output that adds nothing to profit
- C. The addition to total output due to the addition of one unit of all other inputs
- D. The addition to total output due to the addition of the last unit of an input, holding all other inputs constant**

17) Average product is defined as:

- A. Total product divided by the total cost
- B. Total product divided by marginal product
- C. Total product divided by the variable input**
- D. Marginal product divided by the variable input

18) Marginal product crosses the horizontal axis (is equal to zero) at the point where:

- A. Average product is maximized
- B. Total product is maximized**
- C. Diminishing returns set in
- D. Output per worker reaches a maximum

19) The law of diminishing returns refers to diminishing

- A. Total returns
- B. Marginal returns**
- C. Average returns
- D. All of the given options

20) The law of diminishing returns assumes that

- A. There is at least one fixed input**
- B. All inputs are changed by the same percentage
- C. Additional inputs are added in smaller and smaller increments
- D. All inputs are held constant

1- Since $TR = P \times Q$, suppose a perfectly competitive firm increases its production from 10 units to 11 units. If the market price is \$20 per unit, total revenue for 11 units is:

- A. \$20
- B. \$200
- C. \$210
- D. \$220

2- The profit-maximizing level of output for a perfectly competitive firm occurs where:

- A. Marginal revenue equals marginal cost
- B. Total revenue equals total cost
- C. Average revenue equals average total cost
- D. Average revenue equals average variable cost

3- A downward-sloping demand curve exists for:

- A. A monopoly, but not for a perfectly competitive firm
- B. A perfectly competitive firm, but not for a monopoly
- C. Both a monopoly and a perfectly competitive firm
- D. Neither a monopoly nor a perfectly competitive firm

4- Average revenue for a monopolist is:

- A. Greater than price
- B. Less than price
- C. Less than marginal revenue
- D. Greater than marginal revenue

5- Food chains are operating in Pakistan like Mc Donald, KFC and Pizza Hut etc. These food chains sell their products in different countries at different prices. This is an example of:

- A. First-degree price discrimination
- B. Second-degree price discrimination
- C. Third-degree price discrimination
- D. Monopolistic competition

6- You go to the market to purchase mangoes. Suppose 1 KG of mangoes = Rs. 45. If you purchase 1 KG of mangoes, seller will not discount the rate. But if you purchase mangoes in bulk amount then he will sell you at lower price. This is an example of:

- A. First-degree price discrimination
- B. Second-degree price discrimination
- C. Third-degree price discrimination
- D. Monopolistic competition

7- Which of the following is true for both perfect and monopolistic competition?

- A. Firms produce a differentiated product
- B. Firms face a downward sloping demand curve
- C. Firms produce a homogeneous product
- D. There is freedom of entry and exit in the long run

8- A feature of monopolistic competition that makes it similar to monopoly is the:

- A. Inability to influence the price
- B. Downward sloping demand curve
- C. Ease of entry into the industry
- D. Horizontal marginal revenue curve

9- Monopolistic competition is a market structure characterized by:

- A. A single buyer and several sellers
- B. A product with no close substitutes
- C. Barriers to entry and exit
- D. Differentiated products**

10- A feature of oligopoly that makes it similar to monopoly is the:

- A. Inability to influence the price
- B. Downward-sloping demand curve**
- C. Freedom of entry into the industry
- D. Horizontal marginal revenue curve

Quiz # 02 ECO401

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11- The market structure in which each firm is independent in decisions is known as:

- A. Monopolistic competition
- B. Oligopoly
- C. Perfect competition
- D. Monopoly**

12- In the kinked demand curve model, if one firm reduces its price:

- A. Other firms will also reduce their price**
- B. Other firms will compete on a non-price basis
- C. Other firms will raise their price
- D. All of the given options

13- The origins of classical economics can be traced to the work of:

- A. Karl Marx
- B. Milton Friedman
- C. John Maynard Keynes
- D. Adam Smith**

14- Say's Law is a proposition underlying classical economics stating that:

- A. Supply creates its own demand**
- B. Leakages are greater than injections
- C. Unemployment is a common condition
- D. Consumption expenditures are a function of disposable income

15- According to classical economics, the economy was unlikely to experience:

- A. Full employment
- B. Flexible wages and prices
- C. Equality between saving and investment
- D. High rates of unemployment**

16- Classical economics was replaced as the dominant theory of macroeconomic analysis by:

- A. Monetarism
- B. Rational expectations
- C. Keynesian economics**
- D. Neoclassical economics

17- Keynesian economics was largely developed to address the economic problems of the:

- A. Stagflation of the 1970s
- B. Great Depression of the 1930s**
- C. English industrial revolution of the late 1700s

D. American industrial revolution of the late 1800s

18- Keynesian economics was the predominant economic theory:

A. Prior to the late 1700s

B. From the late 1700s to the early 1900s

C. From the 1930s to the 1970s

D. Since the 1970s

19- Keynesian economics rejected the classical assumption that:

A. Supply creates its own demand

B. Prices and wages are inflexible

C. Self-correction takes a long time

D. Consumption expenditures depend on disposable income

20- Aggregate demand curve is downward sloping due to the:

A. Interest rate effect

B. Wealth effect

C. International purchasing power effect

D. All of the given option

21- A primary implication of Keynesian economics is:

A. The best government is the least government

B. Flexible wages and prices ensure full employment

C. Self-correction is the best way to eliminate unemployment

D. Economic instability is best corrected through the interference of government

22- Demand-management policies are designed to shift the:

A. Aggregate Demand curve

B. Aggregate Supply curve

C. Philips curve

D. Production possibilities curve

23- Aggregate supply is the relation between real production and:

A. Scarcity

B. The price level

C. Aggregate expenditures

D. Foreign trade

24- The long-run aggregate supply curve is:

A. Downward sloping

B. Upward sloping

C. Vertical at the full-employment level

D. Horizontal at the full-employment level

25- A leftward shift of the SRAS curve is a (n):

A. Increase in long-run aggregate supply

B. Decrease in long-run aggregate supply

C. Increase in short-run aggregate supply

D. Decrease in short-run aggregate supply

The law of diminishing returns refers to diminishing:

o Total returns.

o MARGINAL RETURNS

o Average returns.

o All of the given options.

In a perfectly competitive market:

- o There are a few buyers.
- o There is a single seller.
- o There is a cartel.
- o No single buyer or seller can significantly affect the market price.

Which of the following is a positive statement?

- o The President of the United States ought to be elected by a direct vote of the American people rather than the Electoral College.
- o A fundamental assumption of the economic theory of consumer behavior is that consumers always prefer having more of any good to having less of it.
- o Because many adults cannot afford to go to college, tax credits for tuition should be introduced.
- o All of the given options.

Which of the following statements about the diagram below is true?

- o Demand is infinitely elastic.
- o Demand is completely inelastic.
- o Demand becomes more inelastic the lower the price.
- o Demand becomes more elastic the lower the price.

Economics is about the allocation of scarce resources. Which of the following is NOT an example of economic scarcity?

- o If Steve goes to see the movie Master and Commander on Saturday, he will not be able to afford buying ice cream.
- o If Jenny studies for her economics quiz this evening, she will not have time to walk her dog.
- o If General Motors increases its production of SUV's this year, it will have to spend more on advertising.
- o If Borders Books increases the number of titles it carries, it will have to reallocate shelf space to accommodate the new titles.

If a 20% increase in price causes quantity supplied to increase by 50%, the price elasticity of supply is:

- o 5/2.
- o 2/5.
- o 5/4.
- o 4/5.

The income elasticity of demand is the:

- o Absolute change in quantity demanded resulting from a one unit increase in income.
- o Percent change in quantity demanded resulting from the absolute increase in income.
- o Percent change in quantity demanded resulting from a one percent increase in income.
- o Percent change in income resulting from a one percent increase in quantity demanded.

The supply curve for a monopolist:

- o Is its marginal cost curve above average variable cost.
- o Is its marginal revenue curve.



o Is the same as the demand curve.

o Does not exist.

Coffee and cream:

- o Are both luxury goods.
- o Are complements.
- o Are both more inelastic in demand in the long run than in the short run.
- o Have a positive cross price elasticity of demand.

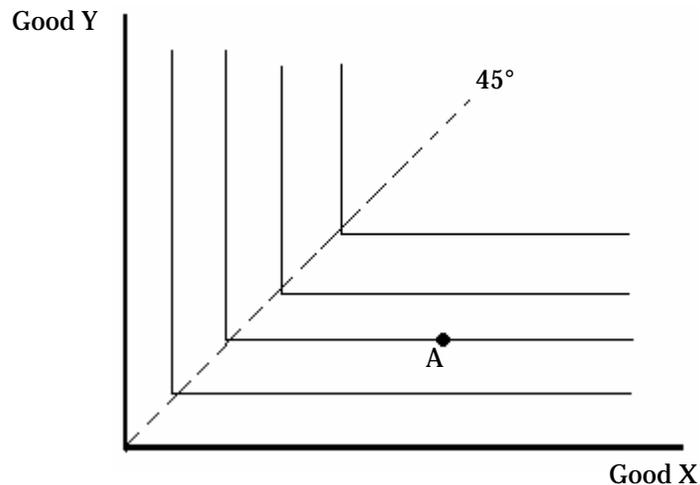
The _____ of a choice is the value of the foregone alternative that was not chosen:

- o fixed cost
- o variable cost
- o opportunity cost
- o sunk cost

1. The slope of an indifference curve reveals:

- a. That preferences are complete.
- b. The marginal rate of substitution of one good for another good.**
- c. The ratio of market prices.
- d. That preferences are transitive.

2. Alvin's preferences for good X and good Y are shown in the diagram below.



Based on Figure it can be inferred that:

- a. Alvin does not consider good X as "good."
- b. Alvin will never purchase any of good Y.
- c. Alvin regards good X and good Y as perfect substitutes.
- d. Alvin regards good X and good Y as perfect complements.**

3. An increase in income, holding prices constant, can be represented as:

- a. A change in the slope of the budget line.
- b. A parallel outward shift in the budget line.**
- c. An outward shift in the budget line with its slope becoming flatter.
- d. A parallel inward shift in the budget line.

4. If prices and income in a two-good society double, what will happen to the budget line?

- a. The intercepts of the budget line will increase.
- b. The intercepts of the budget line will decrease.
- c. The slope of the budget line may either increase or decrease.
- d. There will be no effect on the budget line.**

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5. An individual consumes only two goods, X and Y. Which of the following expressions represents the utility maximizing market basket?

- a. MRS_{xy} is at a maximum.
- b. $P_x/P_y = \text{money income}$.
- c. $MRS_{xy} = \text{money income}$.
- d. $MRS_{xy} = P_x/P_y$.**

6. Which of the following is true regarding income along a price consumption curve?

- a. Income is increasing.
- b. Income is decreasing.
- c. Income is constant.**
- d. The level of income depends on the level of utility.

7. An individual with a constant marginal utility of income will be

- a. Risk averse.
- b. Risk neutral.**
- c. Risk loving.
- d. Insufficient information for a decision.

8. A function that indicates the maximum output per unit of time that a firm can produce, for every combination of inputs with a given technology, is called:

- a. An isoquant.
- b. A production possibility curve.
- c. A production function.**
- d. An isocost function.

9. The short run is:

- a. Less than a year.
- b. Three years.
- c. However long it takes to produce the planned output.
- d. A time period in which at least one input is fixed.**

10. The rate at which one input can be reduced per additional unit of the other input, while holding output constant, is measured by the:

- a. Marginal rate of substitution.
- b. Marginal rate of technical substitution.**
- c. Slope of the isocost curve.
- d. Average product of the input.

1. If, in a fully employed, closed economy, the supply of money and the velocity of circulation of money both increase, then in the short-run.

- a. Unemployment of factors will result

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- 
- b. Real national output will expand
 - c. The volume of transactions will increase
 - d. The average level of prices will rise**

 2. **An increase in the rate of inflation which is not accompanied by any change in the volume of consumer goods sold will automatically increase the:**
 - a. Revenue from Value Added Tax**
 - b. Level of company profits
 - c. Level of unemployment
 - d. Average level of wages

 3. **The increase in the Public Sector Borrowing Requirement (PSBR) to almost £50 billion this year will automatically lead to:**
 - a. A higher rate of inflation
 - b. A fall in the rate of unemployment
 - c. An increase in the National Debt**
 - d. A deterioration in the Balance of Payments

 4. **The investment demand curve shows the relationship between the levels of:**
 - a. Investment and Consumption
 - b. Consumption and Interest Rate
 - c. Investment and Interest Rate**
 - d. None

 5. **According to Classical models, the level of employment is determined primarily by:**
 - a. The level of aggregate demand for goods and services.
 - b. Prices and wages.
 - c. Government taxation.**
 - d. Government spending.

 6. **Which of the following is not an important variable in growth accounting calculations?**
 - a. Productivity growth
 - b. Money supply growth**
 - c. Labor growth
 - d. Capital growth

 7. **The per-worker production function relates:**
 - a. Output per worker to capital per worker.**
 - b. Output per worker to production per worker.
 - c. Output per worker to factors of production per worker.
 - d. Production per worker to the size of the work force.

8. In a steady-state economy:

- a. Net investment equals depreciation rate.
- b. Per capita capital stock grows at the rate of labour growth.
- c. Per capita capital stock remains constant.**
- d. Net investment equals the consumption.

9. The war in Iraq sent oil prices spiraling upwards, resulting in an increase in the overall price level. This is an example of which type of inflation?

- a. Cost-pull
- b. Cost-push**
- c. Demand-pull
- d. Demand-push

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10. The IMF is an agency charged with providing:

- a. Technical assistance to stock market and financial market problems.
- b. Loans for post-World War II reconstruction.
- c. Short-term credit for international balance of payments deficits.**
- d. Bonds denominated in U.S. dollars as a loan to LDCs.

11. In a portfolio investment:

- a. Investors are directly involved in managing the operations.
- b. As in direct investment, investors export goods and services abroad.
- c. Investors transfer the technology to local investors.
- d. Investors have no control over operations.**

12. Inflation:

- a. Reduces both the purchasing power of the dollar and one's real income
- b. reduces the purchasing power of the dollar and increases one's real income
- c. Reduces the purchasing power of the dollar but may have no impact on one's real income**
- d. Increases the purchasing power of the dollar and reduces one's real income

13. One of the tenets of the classical view of the labour market is that the wage adjustments that are necessary to clear the labour market occur:

- a. Slowly.
- b. Quickly.**
- c. Very infrequently.
- d. Instantly.

14. Those that hold the classical view of the labour market are likely to believe that:

- a. Monetary, but not fiscal policy will have an effect on output and employment.
- b. Both monetary and fiscal policy will have an effect on output and employment.
- c. Fiscal, but not monetary policy will have an effect on output and employment.

d. Neither monetary nor fiscal policy will have an effect on output and employment.

15. Potential GDP is the level of aggregate output:

- a. That can be produced if structural unemployment is zero.
- b. That can be produced at a zero unemployment rate.
- c. That can be sustained in the long run, if the inflation rate is zero.
- d. That can be sustained in the long run without inflation.**

16. Which school of economic thought suggested that one possible cause of inflation was a 'push' from the cost side?

- a. New classical economists.
- b. Monetarists.
- c. Marxists.
- d. Keynesians.**

17. An unspoken agreement between workers and firms that the firm will not cut wages is known as:

- a. An explicit contract.
- b. An implicit or social contract.**
- c. Employment-at-will.
- d. A relative-wage contract.

18. To offset the downswing in the business cycle, the government announces a major increase in public expenditure.

- a. Technological Unemployment
- b. Demand Deficient Unemployment**
- c. Real Wage Unemployment
- d. Regional Unemployment

19. The government puts pressure on trade unions to make pay claims which are below the increase in productivity over the past year.

- a. Frictional Unemployment
- b. Technological Unemployment
- c. Structural Unemployment
- d. Real Wage Unemployment**

20. In which case is total expenditure in an economy not equal to total income?

- a. If total saving is larger than total investment
- b. If net exports are not zero
- c. If inventory investment is negative
- d. None of the above--they are always equal**

Q1:

- a. Suppose an economy's real GDP is \$50,000 in year 1 and \$51,200 in year 2. What is the growth rate of its real GDP?
- b. Assume that population was 200 in year 1 and 202 in year 2 and real GDP is \$50,000 in year 1 and \$51,200 in year 2. What is the growth rate of GDP per capita?

(2+6)

Q2.

The following table shows nominal GDP and an appropriate price index for a group of selected years. Compute real GDP.

Year	Nominal GDP, Billions	Price index (1996=100)	Real GDP, Billions
1989	527.4	22.19	\$
1990	911.5	26.29	\$
1991	2295.9	48.22	\$
1992	4742.5	80.22	\$
1993	8790.2	103.22	\$

(Marks=5)

Q3:

What is the multiplier effect? What relationship does the MPC bear to the size of the multiplier?

(Marks=2)

ANSWER1:

- a. Growth rate of real GDP = Real GDP in year 2 – Real GDP in year 1 / Real GDP in year 1

$$\$51,200 - \$50,000 / \$50,000 = 2.4\%$$

- b. GDP per capita in year 1 = Total GDP in year 1 / Total population in year 1

$$\$50,000 / 200 = \$250$$

- GDP per capita in year 2 = Total GDP in year 1 / Total population in year 1

$$\$51,200 / 202 = \$253.46$$

Growth rate of GDP per capita =

- GDP per capita in year 2 – GDP per capita in year 1 / GDP per capita in year 1

$$= 253.46 - \$250 / 250 = 1.38 \text{ percent}$$

ANSWER2:

Real GDP year a = Nominal GDP year a X (Price Index base year / Price Index in year a)

A means current year

Year	Nominal GDP, Billions	Price index (1996=100)	Real GDP, Billions
1960	527.4	22.19	$527.4 * 100 / 22.19 = \$2,376.7$
1968	911.5	26.29	$911.5 * 100 / 26.29 = \$3,467.1$
1978	2295.9	48.22	$2295.9 * 100 / 48.22 = \$4,761.3$
1988	4742.5	80.22	$4742.5 * 100 / 80.22 = \$5,911.9$
1998	8790.2	103.22	$8790.2 * 100 / 103.22 = \$8,516$

ANSWER3:

a. Multiplier effect:

An effect in economics in which an increase in spending produces an increase in national income and consumption greater than the initial amount spent.

The multiplier effect describes how an initial change in spending ripples through the economy to generate a larger change in real GDP. It occurs because of the interconnectedness of the economy, where a change in Haslett's spending will generate more income for Davidic, who will in turn spend more, generating additional income for Grimes.

b. The MPC is directly (positively) related to the size of the multiplier.

Total utility:

“Total utility is the satisfaction achieved by consuming all the units of the commodity considered at a time. For example, if we are considering four units of commodity at present, the total satisfaction derived by the consumption of all the four units will be called total utility”.

Marginal utility:

“Marginal utility is the change in total utility, when an additional unit of the commodity will be consumed”.

The law of diminishing marginal utility:

The law of diminishing marginal utility is based on observations from daily life. The more a person consumes the commodity, the less is the commodity important for him because the desire to consume the commodity may gradually be fulfilled. This observation may be stated as a law, i.e.

Definition:

“The additional benefit which a person derives from an increase of his stock of a thing

diminishes with every increase in the stock he already has”.

In simple words, “the marginal utility of a commodity diminishes as a consumer consumes greater amount of that commodity”.

Example:

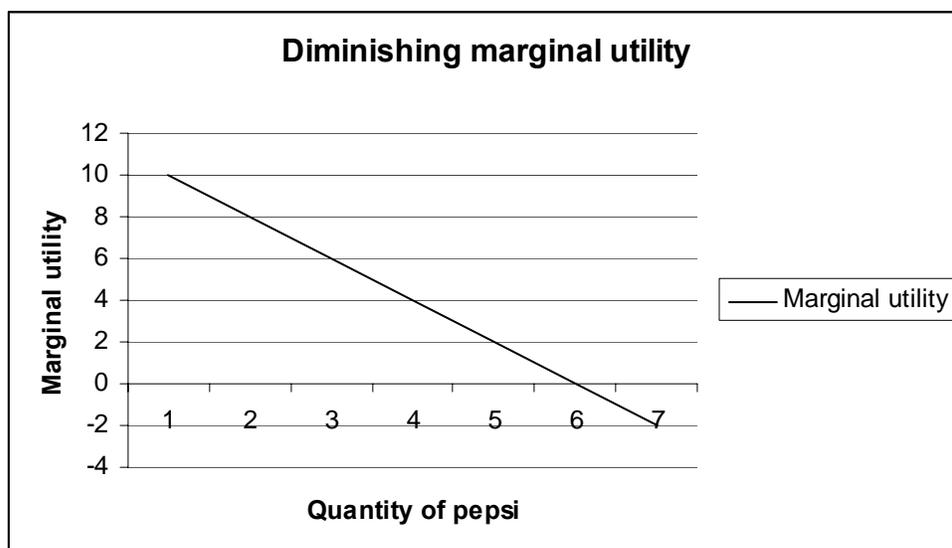
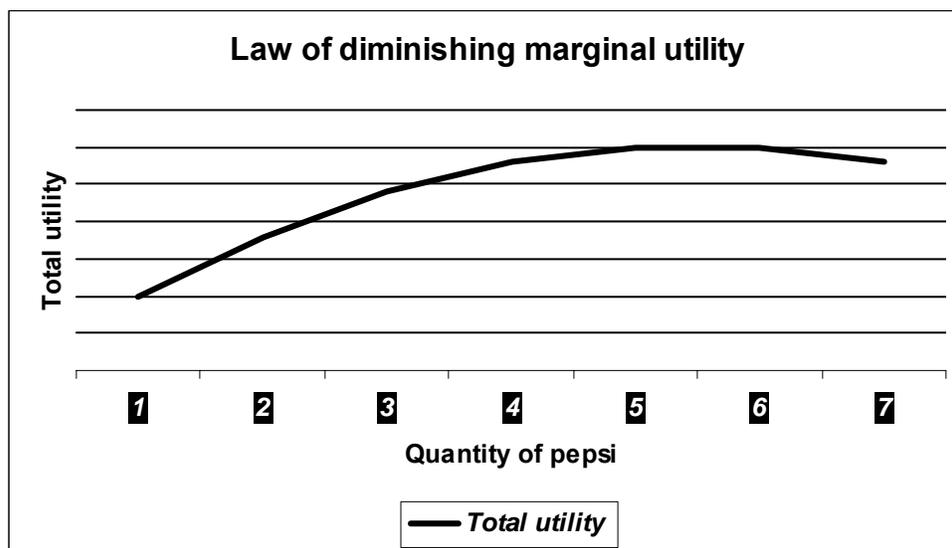
Suppose that a person is considering purchasing small packs of Pepsi. The first pack gives the 10 utils of utility. His desire up to the extent of one pack of Pepsi has been fulfilled. Now he may like to drink the second pack, but, naturally, the desire will be less than before. The second pack may give him only 8 utils. When two packs of Pepsi are consumed, the total satisfaction derived is $10+8=18$ utils. In other words when a person consumed the second (additional) unit of Pepsi, there was a change of 8utils in total utility ($18-10=8$). This is called marginal utility. When the person drinks the third pack of Pepsi, the satisfaction must be less than the second pack, which may be only 6 utils. The satisfaction will continue to decrease and when the point of saturation will come(where there is no desire), than an additional unit(sixth) unit of Pepsi will not add to the level of satisfaction and there will be no change in total utility, i.e. marginal utility will be zero. If he takes seventh pack of Pepsi the pleasure the consumer was having after consuming six pack of Pepsi may decrease,. Total utility may actually decrease, i.e. marginal utility may be negative as shown in table.

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Table:

Units of Pepsi	Total utility(MU)	Marginal utility(MU) Units	Level of desire
1	10	10	Positive
2	18	8	Positive
3	24	6	Positive
4	28	4	Positive
5	30	2	Positive
6	30	0	No desire (point of saturation)
7	28	-2	Negative

Graphs:



Explanation:

Table shows that total utility is maximum (30 utils) when marginal utility is zero. According to this table consumer has a desire to drink more packs of Pepsi until she has consumed 5 units of Pepsi, after which the consumer does not actually desire to drink the sixth pack of Pepsi. This is the point of saturation, because when the consumer consumes or drinks the sixth unit of Pepsi. It does not add the total level of satisfaction. The change in satisfaction (MU) is zero. Here the total utility will be maximum. Further consumption may decrease the total utility which means a negative change in total utility (negative MU).

Assignment question:

Part (a):

The U.S. Department of Agriculture is interested in analyzing the domestic market for corn. The USDA's staff economists estimate the following equations for the demand and supply curves:

$$Q_d = 1,600 - 125P$$

$$Q_s = 440 + 165P$$

Quantities are measured in millions of bushels; prices are measured in dollars per bushel.

- a. Calculate the equilibrium price and quantity that will prevail under a completely free market.
- b. The government currently has a \$4.50 bushel support price in place. What impact will this support price have on the market? Will the government be forced to purchase corn under a program that requires them to buy up any surpluses? If so, how much?

Part (b):

If the demand for butter rises by 4% while the price of margarine rises by 8%, then calculate the cross price elasticity of demand of butter with respect to the price of margarine.

Solution:

Solution Part (a):

- a. In equilibrium,

$$Q_d = Q_s$$

Therefore

$$1,600 - 125P = 440 + 165P$$

$$165P + 125P = 1600 - 440$$

$$290P = 1160$$

$$P = 1160/290$$

$$P = 4$$

Putting the value of price in any of demand and supply equation,

$$Q = 1,600 - 125 \times 4 \text{ (or } 440 + 165 \times 4)$$

$$Q = 1100$$

The equilibrium price is **\$4 per bushels** whereas the equilibrium quantity is **1100 millions of bushels**.

- b. If the government currently has a \$4.50 bushel support price in place, then

Putting $P = \$4.50$ in demand equation,

$$Q_d = 1600 - 125(4.5)$$

$$Q_d = 1037.5$$

Now, putting $P = \$4.50$ in supply equation,

$$Q_s = 440 + 165(4.5)$$

$$Q_s = 1182.5$$

$$\text{Surplus} = Q_s - Q_d = 1182.5 - 1037.5 = 145$$

The support price would create an excess supply of **145 million bushels** that the government would be forced to buy.

Solution Part (b):

Rise in demand for butter = 4%

Rise in price of margarine = 8%

Cross-price elasticity of demand = $\frac{\text{Percentage change in demand for good a}}{\text{Percentage change in price of good b}}$

$$= \frac{4\%}{8\%}$$

$$= 0.5$$

The positive sign with cross-price elasticity of demand shows that these two goods are substitute.

A. Define the law of diminishing marginal utility.

B. The following table shows the total utility that an individual receives from consuming various units of a commodity X.

Q _x	TU _x
1	56
2	104
3	144
4	176
5	200
6	216
7	224
8	224

- Calculate marginal utility at each level.
- Where is the individual's saturation point for commodity X?
- If Price is P=\$8, calculate consumer surplus at each level.

Solution Part A:

Definition:

The law of diminishing marginal utility states that as you consume more and more of a particular good, the satisfaction or utility that you derive from each additional unit falls.

Solution Part B:

- a. As marginal utility is calculated by the formula,

$$MU_x = \frac{\Delta TU_x}{\Delta Q_x}$$

$$MU_x = 56, 48, 40, 32, 24, 16, 8, 0.$$

- b. The saturation point is reached when this individual increases consumption of X from 7 to 8 units. At that point total utility of X is maximum (i.e. 224) and marginal utility of X is zero.
- c. As consumer surplus is calculated by the formula,

$$\text{Consumer surplus} = MU_x - P_x$$

$$\text{Consumer surplus} = 48, 40, 32, 24, 16, 8, 0, -8.$$

If the disposable income (Yd) and consumption for a hypothetical economy is:

Disposable income (Yd)	Consumption (C)
300	300
350	340
400	380
450	420
500	460
550	500

A. With the help of above information, calculate:

- Saving (S)
- Average propensity to consume (APC)
- Average propensity to save (APS) and
- Marginal propensity to consume (MPC)

at each point.

B. What is the relationship between APC and APS?

Solution:

a. Saving(S) = 0, 10, 20, 30, 40 and 50.

Average propensity to consume (APC) = 1.0, 0.97, 0.95, 0.93, 0.92 and 0.90.

Average propensity to save (APS) = 0, 0.03, 0.05, 0.07, 0.08 and 0.10.

Marginal propensity to consume (MPC) is 0.8 at each point.

b. Since disposable income is either consumed or saved, the average propensity to consume plus average propensity to save must equal 1. i.e.

$$\begin{aligned} \text{APS} + \text{APC} &= 1 \\ \text{OR} \\ \text{APC} &= 1 - \text{APS}. \end{aligned}$$

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Assignment Question:

A. Differentiate between short run and long run.

B. If the values of short run quantity (Q), price (P) and total cost (TC) are given, then complete the table given below:

Price (P)	Quantity(Q)	Total cost(TC)	Total revenue (TR)	Profit (π)=	Marginal cost(MC)	Marginal revenue(MR)
8	3	24				
8	4	25				
8	5	28				
8	6	32				
8	7	42				
8	8	64				

Solution Part (A):

Difference between Short-Run and Long-Run:

Short run is a period of time in which at least one of the factors of production is fixed or unchangeable; long run is a period of time in which all the factors of production used in the production are flexible. The actual length of the short run and long-run can vary considerably from industry to industry.

Solution Part (B):

Price (P)	Quantity(Q)	Total cost(TC)	Total revenue (TR) =P.Q	Profit (π)= TR-TC	Marginal cost(MC)= $\Delta\text{TC}/\Delta\text{Q}$	Marginal revenue(MR)= $\Delta\text{TR}/\Delta\text{Q}$
8	3	24	24	0	-	-

8	4	25	32	7	1	8
8	5	28	40	12	3	8
8	6	32	48	16	4	8
8	7	42	56	14	10	8
8	8	64	64	0	22	8

Solution of Assignment # 7

ECO401

Assignment question:

- (a) What were the Classical views about saving?
 (b) What is the meaning of Paradox of thrift? Illustrate Paradox of thrift using a diagram.

(Marks 10)

SOLUTION:

Classical views about saving

Classical economist considered saving as a big virtue of society. They said it is very important for the people to save because more they save, saving curve will shift towards right. This will lower interest rate and will increase investment. Due to more investment in the economy, higher will be the growth rate. So the saving was engine of growth for classical economists.

Meanings of Paradox of Thrift

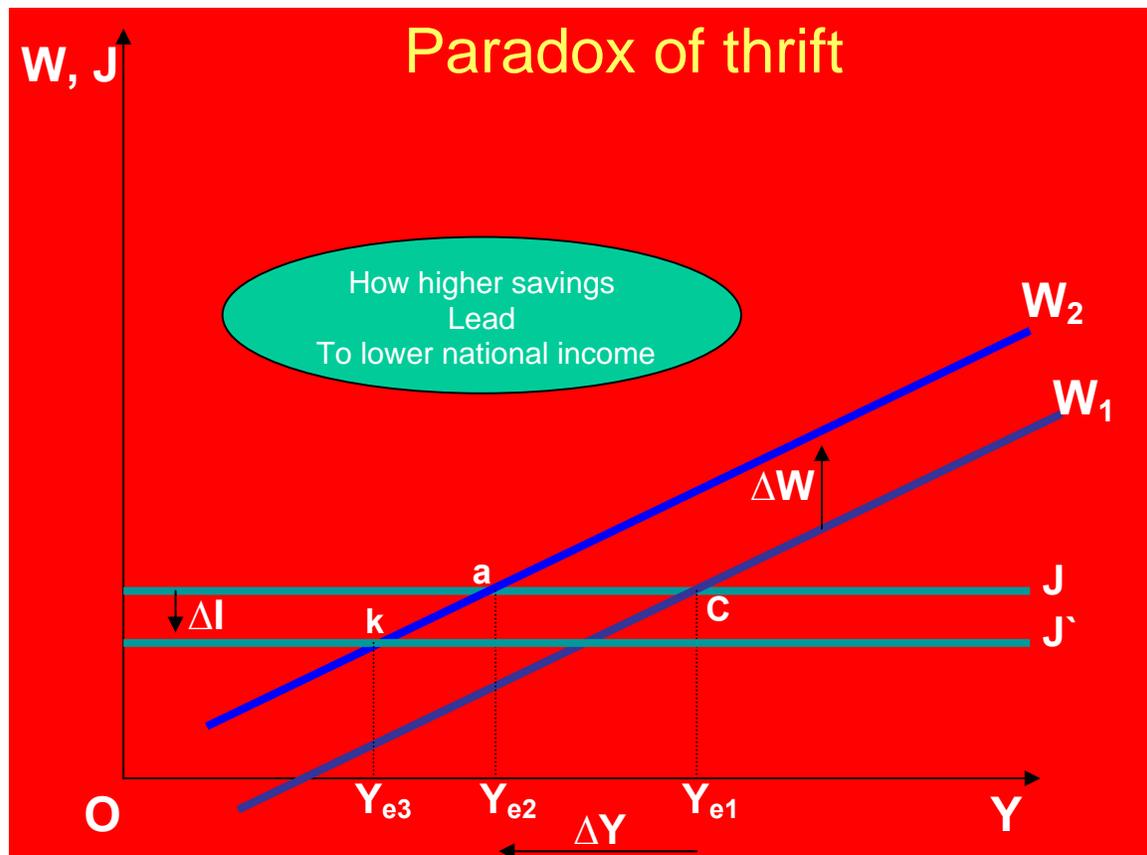
The reverse multiplier effect can be illustrated in the context of Keynes's *paradox of thrift*, which highlights the negative impact of higher saving in an economy in recession. Keynes said that such *thrift* (or conservative saving behavior) would accentuate the recession. As people save more, they will spend less. Firms will therefore produce less, and labor hiring will, as a result, fall, leading to a decline in incomes. This decline would also happen in a multiplied fashion, causing a huge decline in national income. The paradox lies in the fact that saving, while usually considered good for any one individual, can actually be *harmful* to the overall economy if everyone started saving.

Illustration of Paradox of Thrift using a diagram

Paradox of thrift can be illustrated using withdrawals and injections approach to output determination. Withdrawals and injections are taken on vertical axis and the output is taken on horizontal axis.

If people start saving more for a rainy day or something else, the withdrawal function will shift upwards because saving is a form of withdrawals. The withdrawal function will rise from w_1 to w_2 . However if the people save more, they will naturally be able to spend less. If the spending is less, the firms will be able to produce less. There will thus be a multiplied fall in income. The phenomenon of higher savings leading to lower national income is known as Paradox of Thrift i.e., the movement of point c to point a in this diagram that is from output level Y_{e1} to Y_{e2} shows the paradox of thrift that is the disadvantage of being overly prudent.

But this is not all. Far from the extra saving encouraging more investment, the lower consumption will discourage firms from investing. So if investment falls, the J line will shift from J to J'. So there will again be a further multiplied fall in income from Y_{e2} to Y_{e3} . So that was another dimension of Keynes argument. Through all these different arguments, Keynes was advocating the case of fiscal policy expansion in situation of recession.



Discuss the three core rules of elasticity.

(Marks: 05)

Rule # 01

If elasticity is between zero and one ($0 < e < 1$), it is said to be inelastic, if elasticity is greater than one ($e > 1$), it is said to be elastic, if elasticity is equal to zero ($e = 0$), it is said to be unitary elastic and if elasticity is equal to infinity ($e = \infty$), it is said to be infinitely elastic.

Rule # 02

If sign of income elasticity of demand is positive then good is normal and if sign is negative then good is inferior.

Rule # 03

If sign of cross price elasticity of demand is positive then goods are substitutes of each other and if the sign is negative then goods are compliments.

Total Marks =10

Highlight the correct option.

1. Marginal utility measures:

- A. The slope of the indifference curve.
- B. The additional satisfaction from consuming one more unit of a good.**
- C. The slope of the budget line.
- D. The marginal rate of substitution.

2. Which of the following best expresses the law of diminishing marginal utility?

- A. The more a person consumes of a product, the smaller becomes the utility which he receives from its consumption.
- B. The more a person consumes of a product, the smaller becomes the additional utility which she receives as a result of consuming an additional unit of the product.**
- C. The less a person consumes of a product, the smaller becomes the utility which she receives from its consumption.
- D. The less a person consumes of a product, the smaller becomes the additional utility which he receives as a result of consuming an additional unit of the product.

3. A curve that represents all combinations of market baskets that provide the same level of utility to a consumer is called:

- A. A budget line.
- B. An isoquant.
- C. An indifference curve.**
- D. A demand curve.

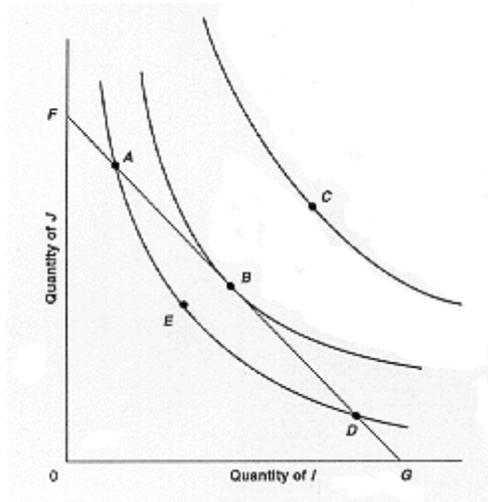
4. The marginal rate of substitution:

- A. May rise or fall, depending on the slope of the budget line.
- B. Rises as you move downward along an indifference curve.
- C. Falls as you move downward along an indifference curve.**
- D. Remains the same along a budget line.

5. Which of the following is a characteristic of the indifference curves?

- A. They are concave to the origin.
- B. They are convex to the origin.**
- C. Curves closer to the origin have the highest level of total utility.
- D. Curves closer to the origin have the highest level of marginal utility.

6. In the diagram given below, the budget line is best represented by the line:



- A. AB
- B. AD
- C. **FG**
- D. DG

7. The endpoints (horizontal and vertical intercepts) of the budget line:

- A. Measure its slope.
- B. Measure the rate at which one good can be substituted for another.
- C. Measure the rate at which a consumer is willing to trade one good for another.
- D. **Represent the quantity of each good that could be purchased if all of the budget were allocated to that good.**

8. If prices and income in a two-good society double, what will happen to the budget line?

- A. The intercepts of the budget line will increase.
- B. The intercepts of the budget line will decrease.
- C. The slope of the budget line may either increase or decrease.
- D. **There will be no effect on the budget line.**

9. If $P_x = P_y$, then when the consumer maximizes utility,

- A. X must equal Y.
- B. **MU(X) must equal MU(Y).**
- C. MU(X) may equal MU(Y), but it is not necessarily so.

D. X and Y must be substitutes.

10. The difference between what a consumer is willing to pay for a unit of a good and what must be paid when actually buying it is called:

- A. Producer surplus.
- B. Consumer surplus.**
- C. Cost-benefit analysis.
- D. Net utility.

Total Marks = 10

Highlight the correct option.

1. Which of following is a key assumption of a perfectly competitive market?

- E. Firms can influence market price.
- F. Commodities have few sellers.
- G. It is difficult for new sellers to enter the market.
- H. Each seller has a very small share of the market.**

2. A firm maximizes profit by operating at the level of output where:

- E. Average revenue equals average cost.
- F. Average revenue equals average variable cost.
- G. Total costs are minimized.
- H. Marginal revenue equals marginal cost.**

3. The demand curve facing a perfectly competitive firm is:

- E. Downward-sloping and less flat than the market demand curve.
- F. Downward-sloping and more flat than the market demand curve.
- G. Perfectly horizontal.**
- H. Perfectly vertical.

4. The monopolist has no supply curve because:

- 
- E. **The quantity supplied at any particular price depends on the monopolist's demand curve.**
 - F. The monopolist's marginal cost curve changes considerably over time.
 - G. The relationship between price and quantity depends on both marginal cost and average cost.
 - H. There is a single seller in the market.

5. A doctor sizes up patients' income and charges wealthy patients more than poorer ones. This pricing scheme represents a form of:

- E. **First-degree price discrimination.**
- F. Second-degree price discrimination.
- G. Third-degree price discrimination.
- H. Pricing at each consumer's reservation price.

6. For which of the following market structures is it assumed that there are barriers to entry?

- E. Perfect competition
- F. Monopolistic competition
- G. **Monopoly**
- H. All of the above

7. A market with few entry barriers and with many firms that sell differentiated products is:

- E. Purely competitive.
- F. A monopoly.
- G. **Monopolistically competitive.**
- H. Oligopolistic.

8. Welfare economics is a branch of economics dealing with:

- A. Social issues.
- B. **Normative issues.**
- C. Political issues.
- D. None of the given options.

9. _____ are goods that people must get a flavor of before they can consider buying them.

- A. Experience goods.
- B. Giffen goods.
- C. Normal goods.
- D. None of the given options.

10. Which of the following does not refer to macroeconomics?

- E. The study of aggregate level of economic activity.
- F. The study of causes of unemployment.
- G. The study of causes of inflation.
- H. The study of the economic behavior of individual decision-making units such as consumers, resource owners and business firms.

Total Marks = 10

Fill in the blanks with appropriate words.

1. **The balance of payments (BOPs)** is an accounting record of a country's transactions with the rest of the world.
2. Any transaction which causes the supply curve of dollars to shift to the right is recorded with a **positive** sign on the BOPs.
3. A growth rate of between **2-3%** is considered normal for mature developed countries.
4. Fiscal deficits and debt are often reported as a ratio of **GDP**.
5. There are two dimensions to the debate over taxation: equity and **efficiency**.

6. The relationship between tax rate and tax revenue collection can be summarized in the **Laffer curve diagram**.
7. **Disposable income** is obtained by subtracting income tax from total income.
8. Money or paper currency serves at least three functions: it is a medium of exchange, a store of value and a **unit of account**.
9. **Monetary policy** can be defined as the central bank's programme, often changing on a daily basis, regarding the direct or indirect control (through interest rates) of monetary conditions in the economy with a view to managing aggregate demand and inflation.
10. Any balance sheet has two sides: **assets** and liabilities.
11. . Costs that vary with the level of activity (or output) are called **variable costs**
12. . Consumer surplus is the **difference** between willingness to pay and what the consumer actually has to pay.
13. . **Marginal utility** is the additional utility derived from the consumption of one or more unit of the good.
14. . **Nepotism** means doing unfair favors for near ones when in power.
15. . Unit elasticity means that a 1% change in price will result in an exact 1% change in **quantity demanded**.

Total Marks = 10

Fill in the blanks with appropriate words.

1. The unemployment rate is defined as the ratio of the **no. of unemployed people** divided by the sum of the employed and unemployed people.
2. **Underemployment** refers to the situation when a person is reported as employed but is actually only doing a part-time job.
3. There are essentially three schools of thought regarding the causes of unemployment: the Classicist, Keynesian and **Monetarist schools**.
4. Keynes located the origins of unemployment in deficient **aggregate demand**.
5. **Frictional unemployment** was defined as unemployment caused by delays in matching job-seekers to jobs.

6. Deflation is the opposite of **inflation** and occurs when the general level of prices falls.
7. **The producer price index (PPI)** is the price index of goods and raw materials sold at the wholesale level to producers.
8. The BOPs can be divided into three parts: current account, **capital account** and changes to reserves.
9. **Equilibrium** in the market for foreign exchange occurs at the point of intersection of the supply and demand curves.
10. The capital account generally provides a direct picture of the **net asset position** of a country vis-à-vis the rest of the world.

subjective

**FINALTERM EXAMINATION
Spring 2009
ECO401- Economics (Session - 2)**

Question No: 51 (Marks: 5)

Briefly discuss the concept of comparative advantage with the help of example.

Question No: 52 (Marks: 10)

- A. Differentiate between Marginal Propensity to Consume (MPC) and Marginal Propensity to Save (MPS).
- B. Suppose a household has the consumption function (C) presented in the figure given below:
- Find consumption when disposable income is \$8,000 and \$10,000.
 - Find consumption when disposable income is \$ 6,000. How can a household consume more than its disposable income?
 - What is true for every point on the 45⁰ line?

(Marks: 4+6)

Question No: 53 (Marks: 10)

Define M0 and M1. Briefly discuss the three broad motives of holding money.

(Marks:4+6)

Question No: 54 (Marks: 10)

Recall the Equation of Quantity theory of money and calculate the missing figure in each of the following cases:

- a. Money supply (M) = 100, Price (P) = 3 and real output (Q) = 200. Calculate the missing figure.
- b. Velocity of money (V) = 4, Price (P) = 5 and output (Q) = 100. Calculate the missing figure.
- c. Money supply (M) = 200, velocity of money (V) = 7 and output (Q) = 700. Calculate the missing figure.
- d. Money supply (M) = 150, velocity of money (V) = 8, Price level (P) = 3. Calculate the missing value.

(Marks: 2.5 each)

FINAL TERM EXAMINATION

Spring 2009

ECO401- Economics (Session - 2)

Question No: 51 (Marks: 5)

Briefly discuss the private cost of advertising. How we can calculate the marginal social cost?

ANSWER: Private Cost Of Advertising: The private cost of advertising is the cost incurred by firm in making the advertisement i.e newspaper ads, tv commercials etc. The firms do not take into account the nuisance faced by people due to these advertisements otherwise the firms would do less advertisement.

Marginal Social Cost: Marginal social cost is not a monetary based cost. It is the cost borne by the society as a whole. It is the cost of consumption of one next unit.

Question No: 52 (Marks: 10)

A. What conclusions are derived from exogenous growth theory?

ANSWER: Exogenous Growth Theory: The major conclusions derived from the exogenous growth are as follows:

- The steady growth rate of real GDP depends on exogenous rates of growth of population (n) and technology (t). There are no policies for government for how to affect the steady growth rate of a country. Higher savings can only have a little effect on income it cannot cause long term growth because savings cause diminishing returns to investment and capital accumulation.
- If one country started with lower income and capital than another country, the poorer country will grow faster to catch up the richer country and then both the countries will grow together.

B. What is meant by convergence theory? Explain the convergence theory in the given graph.

(Marks: 4+6)

Question No: 53 (Marks: 10)

Define fiscal policy. Differentiate between contractionary and expansionary fiscal policy. In which situations, budget deficit and budget surplus exist?

Answer: Fiscal Policy: Fiscal policy is the government's about the

- expenditure in form of purchases, subsidies and interest payments on debt etc.
- revenue in form of taxes etc.

Difference between Contractionary and Expansionary Fiscal Policy:

Contractionary Fiscal Policy	Expansionary Fiscal Policy
In contractionary fiscal policy government decreases its expenditure.	In expansionary fiscal policy government increases its expenditure.

Budget Deficit and Budget Surplus: Budget deficit exists if government expenditure increases the revenue earned. In this case government needs to finance its expenditure through borrowing.

Budget surplus exists when revenue exceeds the government expenditure. In this condition government can easily pay off its debt borrowings.

(Marks: 2+4+4)

Question No: 54 (Marks: 10)

Discuss the basic theories regarding IMF's stabilization program. Are these theories successful? If not, give reasons.

Answer: IMF's Stabilization Theories:

- **Tight Fiscal Policy:** It works through higher revenues and reduced government expenditure.
- **Devaluation:** Switching from imports to home produced goods. It increases competitiveness, exports and increase investors confidence in local currency.
- **Tight Monetary Policy:** Higher interest rates resulting in reduced private sector consumption and investment demand. It reduces inflation and increases savings. High interest rates also results in higher capital inflow.

These theories are generally not successful in lower income countries (LICs). Because they caused the problems of:

- **Devaluation:** It raises the price of imports and also increased the inflation while the real wage rate could not increase.
- **Stabilization hurts poor:** decrease in expenditure always badly effects the poor which can then cause political instability.

MIDTERM EXAMINATION

Fall 2009

ECO401- Economics (Session - 4)

Answers : A)

Risk and Uncertainty : Risk is when an outcome may or may not occur but its probability is known while uncertainty is when an outcome may or may not occur but its probability is not known.

Answers : B)

- 1) For risk neutral person
 - o If Odds Ratio > 1 , then he will definitely buy
 - o If Odds Ratio $= 1$, then he will be indifferent
 - o If Odds Ratio < 1 , then he might not buy as $OR < 1$
- 2) For risk averse person
 - o If Odds Ratio > 1 , then in this case as well he might decide not to buy.
 - o If Odds Ratio $= 1$, then he will definitely not buy
 - o If Odds Ratio < 1 , then he will definitely not buy

- 3) For risk loving person
- o If Odds Ratio > 1 , then he will definitely buy
 - o If Odds Ratio = 1, then he will definitely buy
 - o If Odds Ratio < 1 , then in this case as well he might decide to buy.

Answers : C)

The tossing of a coin and the probability of a head appearing is 50% i.e. the odds of success are fair. So the option of $OR < 1$ and $OR > 1$ is not there. The only possibility is $OR = 1$ which means that the chances are not that bad. Now it depends on the fact that whether I am a risk averse, risk neutral or risk loving person. In case of fair odds both risk loving and risk neutral person might decide to play. So I will play this game as the amount of money involved is not that much and as far as my perception of it is concerned the marginal benefit of gaining 200 Rs is perceived by me as more than the marginal cost of losing the 200 Rs. So I would definitely play this game. Moreover the excitement of winning might overshadow my rational judgement and I would definitely decide to play by being carried away by excitement.

MIDTERM EXAMINATION

Fall 2009

ECO401- Economics (Session - 2)

Question No: 41 (Marks: 10)

Following table shows the price and quantity demanded of a good.

Price	Quantity demanded
2.5	400
5	200
10	100
20	50
40	25

- a) Calculate the total revenue from this table.
- b) Interpret whether the demand is elastic, inelastic or unitary elastic and why?
- c) What will be the shape of demand curve according to the above table? Draw the graph.

MIDTERM EXAMINATION

Spring 2009

ECO401- Economics (Session - 2)

Question No: 41 (Marks: 10)

- A. Define “Law of supply” and explain it with a schedule and diagram.
- B. What are the factors which cause the shift in market supply curve?

(Marks: 6+4)

ANSWER: LAW OF SUPPLY: It states that as the price goes up the quantity supplied also goes up and when price falls quantity supplied also falls.

Schedule for Supply:

Price (Rs.)	Quantity supplied
5	100
4	95
3	80

2	60
1	40

Factors Causing Shift in Supply Curve:

There are various factors causing shift in market supply curve which are as follows:

Factors changing supply	Effect on supply	Direction of Shift in supply	Equilibrium Price	Equilibrium quantity
Increase in number of suppliers	Increase	Rightward shift	Decrease	Increase
Decrease in number of suppliers	Decrease	Leftward shift	Increase	Decrease
Improved technology	Increase	Rightward shift	Decrease	Increase
Declined technology	Decrease	Leftward shift	Increase	Decrease
Increase in future price	Decrease	Leftward shift	Increase	Decrease
Decrease in future price	Increase	Rightward shift	Decrease	Increase
Increase in resources' price	Decrease	Leftward shift	Increase	Decrease
Decrease in resources' price	Increase	Rightward shift	Decrease	Increase

FINAL TERM EXAMINATION

Fall 2008

ECO401- Economics (Session - 3)

Question No: 51 (Marks: 5)

Define foreign exchange markets. Also give some examples of foreign exchange markets.

Foreign exchange markets:

The foreign exchange market is a specific system of a country for a foreign trade and currency exchange. For example, if Pakistan imports a product from USA, Pakistan will buy dollars from rupees, so Pakistan exchanged its currency in foreign market.

Foreign markets depend on imports, exports and currency exchanged process. By these ways two countries exchange their markets.

Question No: 52 (Marks: 10)

What will be the role of government in the foreign exchange market in the following cases?

- a. **If the supply curve of dollars shifts to the right due to rise in exports.**

if the supply curve of dollars shifts to the right due to rise in exports, the government role in foreign markets will be very good. Because due to rise in exports government will exchange money and they will gain high price against its currency. The government will

increase its exports so it raises the price of its currency in foreign exchange.

b. If the demand curve for dollars shifts to right due to rise in imports.

If the demand curves for dollars shifts to right due to rise in imports, the government should decrease the imports rate to save the currency from falling its price. Basically rise in imports decreases the price of currency in foreign exchange markets. So government will slow down the imports and will try to increase its own products to complete the necessary requirement of the country.

(Marks:5+5)

Question No: 53 (Marks: 10)

Define fiscal policy. Differentiate between contractionary and expansionary fiscal policy. In which situations, budget deficit and budget surplus exist?

Fiscal policy:

Fiscal policy is basically a government policy for expenses, imports, exports of goods, benefits from unemployment, interest on debts etc.

Expansionary fiscal policy:

When there is an increase in government spending, there will be more interest rate of bank loan which government has borrowed for spending.

Contractionary fiscal policy:

In this policy the aggregate demand rises due to increase in unemployment rate of country. Unemployment rise the government expenditures.

(Marks: 2+4+4)

Question No: 54 (Marks: 10)

A. If there is a gradual increase in the saving rate over time, would this lead to sustained economic growth? Give your answer with brief explanation.

Definetly, it will increase economic growth rate. As we save more and more money or goods from spendings. Our economical position becomes good. If we have much more savings we can inverst it in a good business or production. This savings will produce more goods and and may be more people will be employed in this process. So our counrty will develop gradually. By this way we will be able top increase our growth rate economically.

B. If this is true, why do people not increase their rate of saving?

Some times People are afraid because of decrease in saving rate and from low exchange rate. They don't put their money in banks. And they sometimes don't invest. For a good economical grwth extra time is required which more people don't want to wait. Sometimes the savings rate from banks is too low.

C. If there is a higher participation rate and GDP per capita rises, would output per worker also rise? Give your answer with brief explanation.

Yes, because when the rate of GDP per capita rises, there will be more and more chances for employment and the life of people will become standard. They will increase the salaries and wages of workers. By this way the workers will be motivated and they will produce more output.

(Marks:4+3+3)