

Name: \_\_\_\_\_

Student id: \_\_\_\_\_



**College of Business Administration  
Department of Economics  
Aggregate Economic Conditions  
ECO 3203  
O. Mikhail  
Fall 2001**

## **Exam II**

- This closed book exam is worth 100 points.  
The exam totals 21 multiple-choice questions and 1 short essay question.  
Each correct multiple-choice answer is worth 4 points.  
There is a BONUS; one extra multiple-choice question.  
The short-essay question is worth 20 points.  
Allocate your time accordingly.
- Answer all the short essay questions in the given space below each question.
- Including the cover page, the exam totals 6 pages.
- Answer the multiple-choice questions on the computer sheet.
- DO NOT forget to write your name and your student id on both: the computer sheet and the exam booklet.
- Non-Programmable calculators and language dictionaries are allowed.
- At the end of the exam, hand-in the exam booklet and the computer sheet to the examiner.

**8:40 a.m. – 9:40 a.m.**

**BA 110**

**October 17, 2001**

## MULTIPLE-CHOICE: (80 points)

1. The wide-spread concern over inflation in the United States
  - a) is irrational since gains and losses from real wealth transfers cancel out over time for the economy as a whole
  - b) stems from the fact that inflation is rarely predictable and households fear losses since they are heavy net holders of fixed dollar assets
  - c) is attributable primarily to increased transfers arising from cost-of-living adjustments
  - d) is irrational since high inflation generally means high growth
  - e) none of the above
  
2. Which of the following is NOT a property of the upward-sloping short-run AS-curve
  - a) if output is above the full-employment level, the AS-curve shifts to the right
  - b) the position of the AS-curve depends on the past level of prices
  - c) the AS-curve becomes steeper as the impact of changes in output and employment on wages becomes larger
  - d) if output is below the full-employment level, the AS-curve will shift to the right
  - e) if wages respond very little to changes in unemployment, the AS-curve is very flat
  
3. If the government stimulates aggregate demand in response to an adverse supply shock,
  - a) the inflation rate will increase but frictional unemployment will decrease
  - b) the unemployment rate will increase but the inflation rate will decline
  - c) an increase in unemployment can be avoided but only at the cost of increased inflation
  - d) the rate of inflation will remain the same while the rate of unemployment will decrease
  - e) the inflation and unemployment rates will be reduced simultaneously
  
4. Most economists prior to Keynes thought
  - a) unemployment could be eliminated by an active fiscal policy
  - b) full employment was the normal condition
  - c) the economy would always adjust to a natural rate of inflation
  - d) monetary policy could eliminate the business cycle
  - e) government intervention was needed to avoid persistent unemployment
  
5. Assume a model with no foreign sector, an income tax rate of zero, and a consumption function defined as  $C = 400 + (0.75)YD$ . When government transfer payments are decreased by 200, then income will
  - a) decrease by 600
  - b) decrease by 800
  - c) increase by 800
  - d) increase by 600
  - e) increase by 150

6. According to the Phillips curve relationship, if unemployment is at the natural rate, then
- a) the rate of inflation is zero
  - b) nominal wages will always be equal to real wages
  - c) the labor supply will be totally price elastic
  - d) prices will always immediately adjust to changes in money supply
  - e) none of the above
7. The upward-sloping AS-curve will shift to the left if
- a) labor force productivity increases
  - b) actual output is lower than the full-employment level
  - c) the markup over labor cost falls
  - d) actual output is higher than the full-employment level
  - e) the level of potential output increases
8. In the Keynesian supply curve case,
- a) firms will always supply the amount of goods demanded at each price
  - b) consumers will demand whatever is supplied by firms at each price
  - c) the economy is always at potential GDP
  - d) unemployment is always at its natural rate
  - e) all of the above
9. In a model with no government and no foreign sector, if autonomous consumption = 80, autonomous investment = 70, and the marginal propensity to save (mps) = 0.25, then equilibrium income is
- a) 150
  - b) 200
  - c) 225
  - d) 600
  - e) 750
10. Assume an economy with no foreign sector, a marginal propensity to save of  $mps = 1/10$ , and a marginal income tax rate of  $t = 1/3$ . If autonomous saving decreases by 300, which of the following is true?
- a) total consumption will increase by 300
  - b) national income will increase by 500
  - c) disposable income will increase by 750
  - d) the budget deficit will decrease by 250
  - e) the budget deficit will be unaffected
11. If inflation this year is higher than expected, then
- a) borrowers will gain at the expense of lenders
  - b) lenders will gain at the expense of borrowers
  - c) both lenders and borrowers will gain and the government will lose
  - d) both lenders and borrowers will lose
  - e) the government will lose unless it has implemented an indexed tax system

12. Which of the following is FALSE?
- a) the AS-curve is horizontal in the Keynesian case
  - b) the AS-curve is vertical in the classical case
  - c) the AS-curve is upward-sloping in the medium run
  - d) the AS-curve is more price elastic in the long run than in the short run
  - e) none of the above
13. Expansionary fiscal policy is very effective in increasing the level of actual output
- a) if the AS-curve is totally price inelastic
  - b) in the classical case
  - c) if the economy is close to full employment
  - d) if the economy is in a recession
  - e) both A) and D)
14. If total autonomous spending is  $A_0 = 800$ , the marginal propensity to consume is  $mpc = 0.8$ , and the marginal tax rate is  $t = 0.25$ , what is the level of equilibrium income?
- a) 800
  - b) 1,000
  - c) 2,000
  - d) 4,000
  - e) 3,200
15. Assume that the savings function is of the form  $S = -100 + (0.2)YD$  and the income tax rate is  $t = 0.25$ . What would be the effect on equilibrium income of a decrease in autonomous consumption of 50?
- a) a decrease in income of 400
  - b) a decrease in income of 250
  - c) a decrease in income of 200
  - d) a decrease in income of 125
  - e) a decrease in income of 100
16. If factor markets were perfectly competitive, then full employment would be the normal condition, and
- a) inflation would always be zero
  - b) the AS-curve would be horizontal
  - c) there would never be any reason for prices to change
  - d) output would rise steadily with price increases
  - e) the AS-curve would be vertical
17. Assume a simple model without any government. If an increase in autonomous investment of 40 leads to an increase in consumption of 160, then the marginal propensity to save is
- a) 0.10
  - b) 0.20
  - c) 0.25
  - d) 0.40
  - e) 0.75

18. Assume a model of the expenditure sector. The marginal propensity to save is 0.2, the marginal propensity to import is 0.1 and the marginal tax rate is 0.25. What is the size of the multiplier?
- a) 2
  - b) 2.5
  - c) 4
  - d) 5
  - e) 10
19. In the medium run the aggregate supply curve is upward sloping since
- a) workers immediately realize that nominal wage increases are only the result of price increases
  - b) firms encounter costs to resetting prices and they are willing to pay workers above market-clearing prices
  - c) wages and prices always immediately change in proportion to the money stock
  - d) there is always natural friction in the labor market that prevents unemployment from reaching zero
  - e) none of the above
20. In a simple model with no government and no foreign sector, a decline in investment of \$10 will lead to a \$50 decline in income if
- a) the mps is 0.2
  - b) the mpc is 0.5
  - c) the ratio of total consumption to total income is 0.8
  - d) changes in consumption divided by changes in income equal 0.2
  - e) changes in saving divided by changes in income equal 0.8
21. In a model with income taxes, a decrease in autonomous investment will
- a) decrease saving
  - b) increase the budget deficit
  - c) decrease tax revenues
  - d) decrease consumption
  - e) all of the above

**SHORT ESSAY QUESTION: (20 points)**  
**ANSWER IN THE GIVEN SPACE BELOW THE QUESTION**  
**BE CLEAR, BRIEF and USE GRAPHS WHENEVER POSSIBLE**

**QUESTION I: (20 points)**

July 2001; the economy is in recession and the price level is stable.

September 2001; following the cowardly act of September 11, the U.S. decided to military retaliate.

First, graph AD/AS then highlight each point on the graph. Second, explain why and illustrate how did the economy move from one point to a second. Give a description of the state of the economy in the Short Run and in the Long Run.

## Answer Key

1. b stems from the fact that inflation is rarely predictable and households fear losses since they are heavy net holders of fixed dollar assets
2. a if output is above the full-employment level, the AS-curve shifts to the right
3. c an increase in unemployment can be avoided but only at the cost of increased inflation
4. b full employment was the normal condition
5. a decrease by 600
6. e none of the above
7. d actual output is higher than the full-employment level
8. a firms will always supply the amount of goods demanded at each price
9. d 600
10. d the budget deficit will decrease by 250
11. a borrowers will gain at the expense of lenders
12. d the AS-curve is more price elastic in the long run than in the short run
13. d if the economy is in a recession
14. c 2,000
15. d a decrease in income of 125
16. e the AS-curve would be vertical
17. b 0.20
18. a 2
19. b firms encounter costs to resetting prices and they are willing to pay workers above market-clearing prices
20. a the mps is 0.2
21. e all of the above