

Name: _____

Student id: _____



**College of Business Administration
Department of Economics
Economic Foundations for MBA
ECO 5937 – Section (2)
O. Mikhail
Fall 2001**

Final Exam

- This closed book exam is worth 100 points.
The exam totals 43 multiple-choice questions and 2 short essay questions.
For the multiple-choice part: Only your first 35 correct answers will count.
Each correct multiple-choice answer is worth 2.3 points.
For the short-essay part: The 2 questions are worth 20 points.
Each short-essay question is worth 10 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 12 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.

6:15 p.m. – 8:15 p.m.

BA 146

October 9, 2001

MULTIPLE-CHOICE: (80 points)

1. Which of the following is FALSE?
 - a) If the SRAS curve is positively sloped, the multiplier is smaller than the simple multiplier.
 - b) If the SRAS curve is horizontal, the multiplier is equal to the simple multiplier.
 - c) As long as the AD curve is downward sloping, the size of the multiplier is determined by the slope of the SRAS curve.
 - d) If the SRAS curve is horizontal, the multiplier is infinite.
 - e) If the SRAS curve is vertical, the multiplier is zero.

2. If the output gap measures the output that the economy has lost because of its failure to achieve full employment, it can be concluded that the larger the output gap
 - a) the more upward pressure there is on prices.
 - b) the greater is the employment rate.
 - c) the lower is frictional unemployment.
 - d) the greater is the unemployment rate.
 - e) the lower the dead-weight loss of unemployment.

3. In the national accounts, a drawing down of inventories counts as
 - a) disinvestment.
 - b) depreciation.
 - c) investment.
 - d) saving.
 - e) consumption.

Use the following to answer questions 4 and 5:

1995	Price	Quantity
Good A	\$1.00	100 units
Good B	\$2.00	200 units
Good C	\$5.00	100 units

1996	Price	Quantity
Good A	\$2.00	120 units
Good B	\$3.00	200 units
Good C	\$10.00	98 units

4. The real GDP in 1996, expressed in 1995 dollars, from the table above was
 - a) \$700.
 - b) \$1740.
 - c) \$840.
 - d) \$970.
 - e) \$1010.

5. If 1995 is the base year in the table above, the implicit price index in 1995 was
- \$1000.
 - 180.
 - 102.
 - 193.
 - 100.
6. In a macroeconomic model with no government or foreign trade, the only "injection" is
- transfer payments.
 - autonomous consumption.
 - induced consumption.
 - saving.
 - investment.
7. If $(S+T+IM)$ exceeds $(I+G+X)$, injections _____ leakages and national output will _____ toward its equilibrium level.
- exceed, fall
 - fall short of, fall
 - fall short of, rise
 - exceed, rise
8. Which of the following is an example of an AD shock?
- because of free trade, U.S. businesses decide to increase their investment expenditures
 - a severe drought lasts for six months
 - a government budget announces a substantial increase in government purchases
- 1 and 3 only
 - 2 only
 - 1 and 2 only
 - 1 only
 - 3 only
9. The price level and desired aggregate expenditure are related to each other
- positively.
 - negatively.
 - in an unknown way.
 - progressively.
 - proportionally.
10. An expression for national saving is
- $S + T + G$.
 - $S - T - G$.
 - $S + (T - G)$.
 - $S - T + G$.
 - $S - (T - G)$.

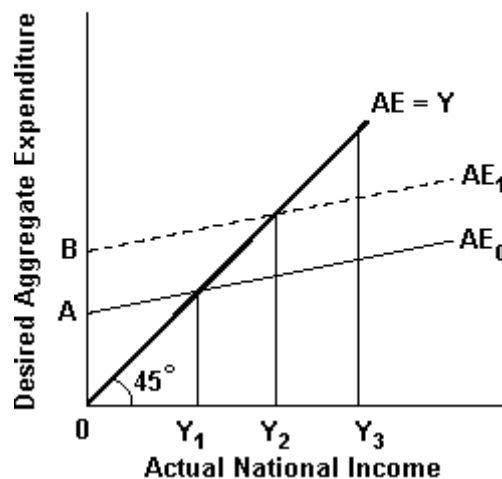
11. The real rate of interest is equal to the
- a) nominal rate of interest minus the rate of inflation.
 - b) real rate of interest divided by the nominal rate of interest.
 - c) nominal rate of interest divided by the price level.
 - d) nominal rate of interest plus the risk ratio.
 - e) the rate of inflation minus the real rate of interest.
12. The short-run aggregate supply curve slopes upward because
- a) inputs become more expensive at higher levels of output.
 - b) inputs become less expensive at higher levels of output.
 - c) aggregate demand increases at higher levels of national income.
 - d) unit costs fall at higher levels of output.
 - e) unit costs rise at higher levels of output.
13. To calculate GDP from the expenditure side, one must add together
- a) wages, profits, government purchases and net exports.
 - b) consumption, investment, government purchases, and exports.
 - c) wages, rent, interest, and profits.
 - d) consumption, investment, government purchases, and net exports.
 - e) consumption, government purchases, and interest.
14. The net export function indicates a _____ relationship between _____ and national income.
- a) negative, net exports
 - b) negative, imports
 - c) negative, exports
 - d) positive, net exports
 - e) positive, exports
15. Disposable personal income is
- a) GNP minus that part of it not actually paid to households, plus transfer payments to households.
 - b) equal to the gross wages received by the household.
 - c) personal income plus transfers, minus personal taxes paid by households.
 - d) GNP minus that part of it not actually paid to households, plus transfer payments to households, minus personal taxes paid by households.
 - e) GNP minus that part of it not actually paid to households, minus personal income taxes paid by households.
16. As the banking industry becomes more and more automated, tellers find themselves with unneeded skills at the same time that computer programmers and telephone banking specialists are in high demand. Such unemployed tellers would be classified as
- a) underemployed.
 - b) structurally unemployed.
 - c) cyclically unemployed.
 - d) naturally unemployed.

- e) frictionally unemployed.
17. In a simple macroeconomic model, with a closed economy and no government, the aggregate expenditure function is the sum of
- a) desired consumption and desired investment.
 - b) saving and desired investment.
 - c) actual consumption and actual investment.
 - d) consumption and disposable income.
 - e) consumption and saving.
18. With a rise in domestic national income,
- a) the net exports curve pivots upward.
 - b) the net exports line pivots downward.
 - c) net exports are unaffected.
 - d) the net exports curve shifts upward.
 - e) we move downward along the net exports line.
19. Adding imports to the macro model causes the AE curve to
- a) become steeper.
 - b) remain stationary.
 - c) become flatter.
 - d) shift upward parallel.
 - e) shift downward parallel.
20. The "circular-flow" diagram shows that producing a certain value of output gives rise to
- a) a smaller value of claims on that output, due to taxation.
 - b) a smaller value of claims on that output, due to importing.
 - c) a larger value of claims on that output, due to value added.
 - d) an equal value of claims on that output.
 - e) a smaller value of claims on that output, due to household saving.
21. GDP measures tend to understate the economic welfare of less-developed countries because those countries tend to
- a) import much more than they export.
 - b) have a large share of nonmarket activities.
 - c) have a high degree of foreign direct investment.
 - d) have very high rates of pollution.
 - e) emphasize agricultural and resource-based production.
22. The multiplier can be defined as
- a) national income divided by aggregate expenditure.
 - b) the change in national income resulting from a change in saving.
 - c) a change in aggregate expenditures multiplied by the equilibrium level of national income.
 - d) the change in equilibrium national income divided by the initial change in autonomous expenditure

- that brought it about.
- e) the change in national income resulting from a change in expenditure, multiplied by the number of years since the initial change.
23. Over the flat range of the SRAS, a rightward shift of the AD curve will
- result in a decrease in both output and prices.
 - not affect either output or prices.
 - result in an increase in prices but not output.
 - result in an increase in both output and prices.
 - result in an increase in output but not prices.
24. If desired aggregate expenditures are below the current level of national income, the amount by which the 45-degree line is above the AE line represents
- desired accumulation of inventories.
 - the amount by which output exceeds desired expenditures.
 - desired decumulation of inventories.
 - the amount by which desired expenditures exceeds output.
 - the output gap.
25. One reason that the aggregate demand curve slopes downward is
- that aggregate expenditure increases as the price level rises.
 - that an increase in the price level causes consumers to substitute foreign goods for domestic goods.
 - that increased production results in lower production costs.
 - that when the price level falls firms must compete more when output increases.
 - all of the above.

Use the following to answer question 26:

Figure 2302



26. According to Figure 2302, if national income is Y_1 , and aggregate expenditure is AE_1 , then desired

aggregate expenditure

- a) is equal to income and will not change.
- b) is less than income and income must fall.
- c) exceeds income and income must fall.
- d) is less than income and income must rise.
- e) exceeds income and income must rise.

27. The SRAS has a positive slope because, as the price level rises, business firms will

- a) accumulate inventories.
- b) experience rising factor prices.
- c) produce the same output, but at higher prices.
- d) be compensated for the extra costs incurred to produce more output.
- e) produce less in response to falling profits.

28. Booms are not without their problems, particularly

- a) pressure on the government budget deficit to rise.
- b) excessive labour-force participation.
- c) deflationary pressure.
- d) inflationary pressure.
- e) rising real interest rates.

29. Common usage of the term "recession" defines it as

- a) a fall in the real GDP for at least four quarters.
- b) a fall in the real GDP for at least two quarters.
- c) a fall in the real GDP for at least three quarters.
- d) a fall in the real GDP for at least one quarter.

30. Disposable personal income

- a) is the part of national income that is available to households to spend or save.
- b) equals personal income, minus personal income taxes, plus transfer payments and interest on public debt.
- c) includes capital consumption allowances.
- d) is equal to wages.
- e) includes undistributed corporate profits.

31. When national income exceeds desired aggregate expenditure,

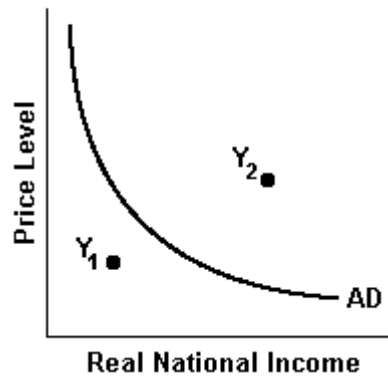
- a) desired national asset formation exceeds desired national saving by an equal amount.
- b) desired national saving exceeds desired national asset formation by an equal amount.
- c) desired national asset formation is below zero.
- d) desired national saving is below zero.
- e) none of the above

32. Suppose a firm imports \$1,000 worth of bananas and sells them for \$2,000. The effect on GDP would be
- a) no effect on GDP since the bananas were produced outside of U.S.
 - b) to increase the value of GDP by \$3,000.
 - c) to increase the value of GDP by \$2,000.
 - d) to increase the value of GDP by \$1,000.
 - e) to decrease the value of GDP by \$3,000.
33. The requirement for equilibrium in the simple macro model (closed economy, no government) with a given price level is that
- a) consumption equals desired investment.
 - b) desired saving equals zero.
 - c) desired investment equals actual saving.
 - d) desired saving equals desired investment.
 - e) desired investment equals zero.
34. If the expected rate of inflation is 3 percent, and contract negotiators agree that real wages should rise by 5 percent, the two sides will agree to an increase in money wages of
- a) 2 percent.
 - b) 5 percent.
 - c) 8 percent.
 - d) 3 percent.
35. In studying short-run income fluctuations, potential income is usually assumed
- a) to be equal to actual income.
 - b) not to exist.
 - c) to be falling at its long-run average growth rate.
 - d) to be constant.
 - e) to be rising.
36. When national income exceeds desired aggregate expenditures, inventory _____ will induce firms to _____ the rate of output production.
- a) depletion, lower
 - b) buildup, lower
 - c) buildup, raise
 - d) depletion, raise
37. There will be no real effects from inflation as long as
- a) the actual rate of inflation is less than 5 percent.
 - b) the anticipated rate of inflation is more than the actual rate of inflation.
 - c) the anticipated rate of inflation is less than the actual rate of inflation.
 - d) no one realizes that it is happening.
 - e) the inflation is fully anticipated and no one changes their behaviour.

38. A price-taking firm will
- a) adjust its price to the output determined by supply and demand.
 - b) behave in the same way with respect to output decisions as a price-setting firm.
 - c) produce more only if price rises.
 - d) produce as much as possible.
 - e) increase their prices when they expand output into the range where unit costs are rising.
39. Suppose $G = 400$ and the income-tax rate is 20 percent. Government saving is negative for all values of Y
- a) below 8000.
 - b) above 8000.
 - c) below 2000.
 - d) above 2000.
40. Over the intermediate range of the SRAS curve, a rightward shift of the AD curve will
- a) result in an increase in both output and prices.
 - b) result in an increase in prices but not output.
 - c) not affect either output or prices.
 - d) result in an increase in output but not prices.
 - e) result in a decrease in both output and prices.
41. The largest component of domestic investment is
- a) plant and equipment.
 - b) financial assets.
 - c) residential housing.
 - d) inventories.
 - e) none of the above.
42. If a country is experiencing inflation, the nominal national product
- a) will overstate the real value of production.
 - b) will understate the value of national income.
 - c) will overstate the inflation rate.
 - d) will equal real national product.
 - e) none of the above

Use the following to answer question 43:

Figure 2501



43. In Figure 2501, which of these statements about point Y_2 is most likely to be true?
- a) Y_2 is a short-run equilibrium point.
 - b) The point corresponding to Y_2 on the aggregate expenditure function is above the 45 degree line.
 - c) The corresponding point on the aggregate expenditure curve is on the 45-degree line.
 - d) Output and the price level will tend to rise.
 - e) Desired aggregate expenditure is less than national income.

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

QUESTION I: (10 points)

Explain why a sudden, unexpected fall in consumer expenditure would initially cause an increase in actual investment expenditure by firms.

SOLUTION:

A decrease in consumption expenditure will increase inventories and therefore it will influence Investment (since inventories are measured as part of investment).

QUESTION II: (10 points)

Show each point on the AD/AS graph:

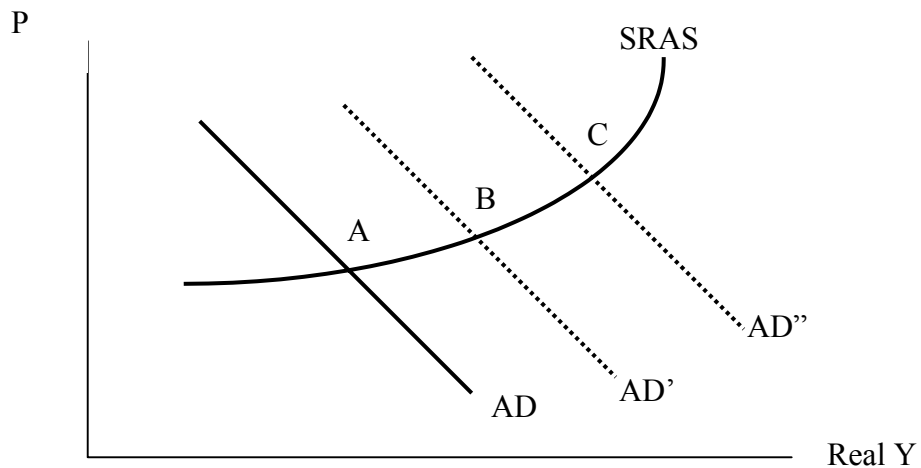
Point A: July 2001; the economy is in recession and the price level is stable.

Point B: August 2001; the government adopts an income tax cut plan.

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

First, graph AD/AS then highlight each point (A, B and C) on the graph. Second, explain why and illustrate how did the economy move from point A to point B to point C. Give a description of the state of the economy following each action.

SOLUTION:



Answer Key

1. d If the SRAS curve is horizontal, the multiplier is infinite.
Topic: Macro Equilibrium
2. d the greater is the unemployment rate.
Topic: Output and Total Income
3. a disinvestment.
Topic: National Income Accounting: The Basics
4. e \$1010.
Topic: National Income Accounting: Extra Issues
5. e 100.
Topic: National Income Accounting: Extra Issues
6. e investment.
Topic: Equilibrium National Income
7. b fall short of, fall
Topic: Equilibrium National Income
8. a 1 and 3 only
Topic: Macro Equilibrium
9. b negatively.
Topic: Demand Side of the Economy
10. c $S + (T - G)$.
Topic: Equilibrium National Income
11. a nominal rate of interest minus the rate of inflation.
Topic: Inflation and Interest Rates
12. e unit costs rise at higher levels of output.
Topic: Supply Side of the Economy
13. d consumption, investment, government purchases, and net exports.
Topic: National Income Accounting: The Basics
14. a negative, net exports
Topic: Introducing Net Exports
15. c personal income plus transfers, minus personal taxes paid by households.
Topic: National Income Accounting: Extra Issues

16. b structurally unemployed.
Topic: Employment and Unemployment
17. a desired consumption and desired investment.
Topic: Desired VS. Actual Expenditure
18. e we move downward along the net exports line.
Topic: Introducing Net Exports
19. c become flatter.
Topic: Equilibrium National Income
20. d an equal value of claims on that output.
Topic: Output and Total Income
21. b have a large share of nonmarket activities.
Topic: National Income Accounting: Extra Issues
22. d the change in equilibrium national income divided by the initial change in autonomous expenditure that brought it about.
Topic: Changes in Equilibrium National Income
23. e result in an increase in output but not prices.
Topic: Macro Equilibrium
24. b the amount by which output exceeds desired expenditures.
Topic: Equilibrium National Income
25. b that an increase in the price level causes consumers to substitute foreign goods for domestic goods.
Topic: Demand Side of the Economy
26. e exceeds income and income must rise.
Topic: Changes in Equilibrium National Income
27. d be compensated for the extra costs incurred to produce more output.
Topic: Supply Side of the Economy
28. d inflationary pressure.
Topic: Output and Total Income
29. b a fall in the real GDP for at least two quarters.
Topic: Applications and Extensions
30. a is the part of national income that is available to households to spend or save.

Topic: National Income Accounting: Extra Issues

31. b desired national saving exceeds desired national asset formation by an equal amount.
Topic: Equilibrium National Income
32. d to increase the value of GDP by \$1,000.
Topic: National Income Accounting: The Basics
33. d desired saving equals desired investment.
Topic: Equilibrium National Income
34. c 8 percent.
Topic: Inflation and Interest Rates
35. d to be constant.
Topic: Output and Total Income
36. b buildup, lower
Topic: Equilibrium National Income
37. e the inflation is fully anticipated and no one changes their behaviour.
Topic: Inflation and Interest Rates
38. c produce more only if price rises.
Topic: Supply Side of the Economy
39. c below 2000.
Topic: Introducing Government
40. a result in an increase in both output and prices.
Topic: Macro Equilibrium
41. a plant and equipment.
Topic: Investment and AE
42. a will overstate the real value of production.
Topic: Inflation and Interest Rates
43. e Desired aggregate expenditure is less than national income.
Topic: Demand Side of the Economy

ESSAY QUESTION 1: Chapter 23, p. 508, Question 6. Emphasis the role of inventories.