

Name: _____

Student id: _____



College of Business Administration
Department of Economics
Economic Foundations for MBA
ECO 5937 – Section (4)
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.

CL1-122

October 11, 2001

MULTIPLE-CHOICE: (80 points)

1. The SRAS has a positive slope because, as the price level rises, business firms will
 - a) accumulate inventories.
 - b) produce less in response to falling profits.
 - c) produce the same output, but at higher prices.
 - d) experience rising factor prices.
 - e) be compensated for the extra costs incurred to produce more output.

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

3. Which of the following is an example of an AD shock?
 1. because of free trade, U.S. businesses decide to increase their investment expenditures
 2. a severe drought lasts for six months
 3. a government budget announces a substantial increase in government purchases
 - a) 1 only
 - b) 1 and 2 only
 - c) 1 and 3 only
 - d) 2 only
 - e) 3 only

4. 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) result in an increase in output but not prices.
 - d) not affect either output or prices.
 - e) result in a decrease in both output and prices.

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

6. The net export function indicates a _____ relationship between _____ and national income.
- positive, exports
 - negative, exports
 - negative, imports
 - positive, net exports
 - negative, net exports
7. If a country is experiencing inflation, the nominal national product
- will understate the value of national income.
 - will overstate the inflation rate.
 - will overstate the real value of production.
 - will equal real national product.
 - none of the above
8. Over the flat range of the SRAS, a rightward shift of the AD curve will
- not affect either output or prices.
 - result in a decrease in both output and 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.

Use the following to answer questions 9-10:

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

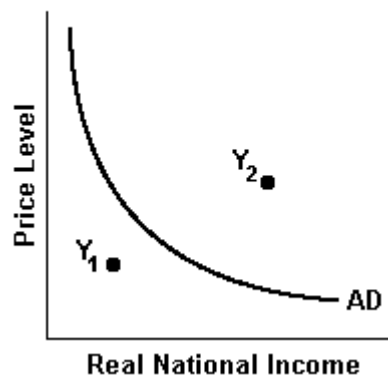
9. The real GDP in 1996, expressed in 1995 dollars, from the table above was
- \$700.
 - \$840.
 - \$1010.
 - \$1740.
 - \$970.
10. If 1995 is the base year in the table above, the implicit price index in 1995 was
- 102.
 - \$1000.
 - 180.
 - 193.
 - 100.

11. Disposable personal income
- a) is the part of national income that is available to households to spend or save.
 - b) is equal to wages.
 - c) includes undistributed corporate profits.
 - d) includes capital consumption allowances.
 - e) equals personal income, minus personal income taxes, plus transfer payments and interest on public debt.
12. A price-taking firm will
- a) adjust its price to the output determined by supply and demand.
 - b) produce more only if price rises.
 - c) increase their prices when they expand output into the range where unit costs are rising.
 - d) produce as much as possible.
 - e) behave in the same way with respect to output decisions as a price-setting firm.
13. In a simple macroeconomic model, with a closed economy and no government, the aggregate expenditure function is the sum of
- a) actual consumption and actual investment.
 - b) consumption and disposable income.
 - c) desired consumption and desired investment.
 - d) saving and desired investment.
 - e) consumption and saving.
14. There will be no real effects from inflation as long as
- a) the anticipated rate of inflation is more than the actual rate of inflation.
 - b) the inflation is fully anticipated and no one changes their behaviour.
 - c) the anticipated rate of inflation is less than the actual rate of inflation.
 - d) the actual rate of inflation is less than 5 percent.
 - e) no one realizes that it is happening.
15. 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
- a) the amount by which output exceeds desired expenditures.
 - b) the amount by which desired expenditures exceeds output.
 - c) desired accumulation of inventories.
 - d) desired decumulation of inventories.
 - e) the output gap.
16. Booms are not without their problems, particularly
- a) deflationary pressure.
 - b) inflationary pressure.
 - c) excessive labour-force participation.
 - d) pressure on the government budget deficit to rise.
 - e) rising real interest rates.

17. When national income exceeds desired aggregate expenditures, inventory _____ will induce firms to _____ the rate of output production.
- buildup, raise
 - buildup, lower
 - depletion, lower
 - depletion, raise
18. The largest component of domestic investment is
- residential housing.
 - inventories.
 - plant and equipment.
 - financial assets.
 - none of the above.
19. The price level and desired aggregate expenditure are related to each other
- negatively.
 - in an unknown way.
 - proportionally.
 - progressively.
 - positively.

Use the following to answer question 20:

Figure 2501



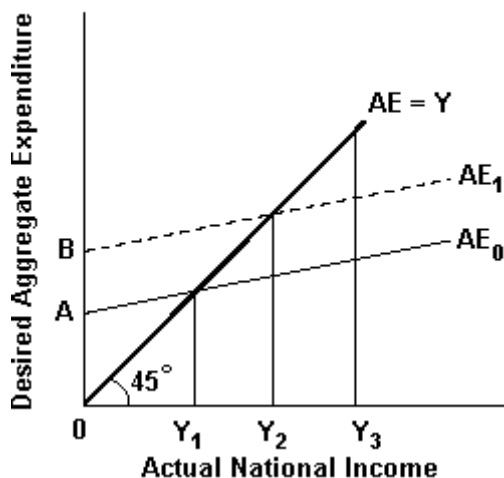
20. In Figure 2501, which of these statements about point Y_2 is most likely to be true?
- The corresponding point on the aggregate expenditure curve is on the 45-degree line.
 - Y_2 is a short-run equilibrium point.
 - The point corresponding to Y_2 on the aggregate expenditure function is above the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

21. An expression for national saving is
- a) $S - T - G$.
 - b) $S + T + G$.
 - c) $S - (T - G)$.
 - d) $S - T + G$.
 - e) $S + (T - G)$.
22. Adding imports to the macro model causes the AE curve to
- a) shift upward parallel.
 - b) become flatter.
 - c) become steeper.
 - d) remain stationary.
 - e) shift downward parallel.
23. Suppose $G = 400$ and the income-tax rate is 20 percent. Government saving is negative for all values of Y
- a) below 2000.
 - b) above 2000.
 - c) below 8000.
 - d) above 8000.
24. Which of the following is FALSE?
- a) If the SRAS curve is horizontal, the multiplier is infinite.
 - 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 vertical, the multiplier is zero.
 - e) If the SRAS curve is positively sloped, the multiplier is smaller than the simple multiplier.
25. The short-run aggregate supply curve slopes upward because
- a) aggregate demand increases at higher levels of national income.
 - b) inputs become more expensive at higher levels of output.
 - c) inputs become less expensive at higher levels of output.
 - d) unit costs fall at higher levels of output.
 - e) unit costs rise at higher levels of output.
26. In a macroeconomic model with no government or foreign trade, the only "injection" is
- a) transfer payments.
 - b) investment.
 - c) induced consumption.
 - d) autonomous consumption.
 - e) saving.

27. With a rise in domestic national income,
- the net exports curve pivots upward.
 - the net exports curve shifts upward.
 - the net exports line pivots downward.
 - net exports are unaffected.
 - we move downward along the net exports line.
28. 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
- underemployed.
 - frictionally unemployed.
 - structurally unemployed.
 - cyclically unemployed.
 - naturally unemployed.
29. 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
- the greater is the unemployment rate.
 - the lower is frictional unemployment.
 - the lower the dead-weight loss of unemployment.
 - the more upward pressure there is on prices.
 - the greater is the employment rate.
30. The real rate of interest is equal to the
- nominal rate of interest plus the risk ratio.
 - the rate of inflation minus the real rate of interest.
 - real rate of interest divided by the nominal rate of interest.
 - nominal rate of interest minus the rate of inflation.
 - nominal rate of interest divided by the price level.
31. 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
- 2 percent.
 - 8 percent.
 - 3 percent.
 - 5 percent.
32. The requirement for equilibrium in the simple macro model (closed economy, no government) with a given price level is that
- consumption equals desired investment.
 - desired investment equals zero.
 - desired investment equals actual saving.
 - desired saving equals desired investment.
 - desired saving equals zero.

Use the following to answer question 33:

Figure 2302



33. According to Figure 2302, if national income is Y_1 , and aggregate expenditure is AE_1 , then desired aggregate expenditure
- exceeds income and income must rise.
 - is less than income and income must rise.
 - is less than income and income must fall.
 - is equal to income and will not change.
 - exceeds income and income must fall.
34. Suppose a firm imports \$1,000 worth of bananas and sells them for \$2,000. The effect on GDP would be
- to increase the value of GDP by \$1,000.
 - to increase the value of GDP by \$3,000.
 - no effect on GDP since the bananas were produced outside of the U.S.
 - to decrease the value of GDP by \$3,000.
 - to increase the value of GDP by \$2,000.
35. One reason that the aggregate demand curve slopes downward is
- that increased production results in lower production costs.
 - that an increase in the price level causes consumers to substitute foreign goods for domestic goods.
 - that when the price level falls firms must compete more when output increases.
 - that aggregate expenditure increases as the price level rises.
 - all of the above.
36. Common usage of the term "recession" defines it as
- a fall in the real GDP for at least four quarters.
 - a fall in the real GDP for at least two quarters.
 - a fall in the real GDP for at least three quarters.
 - a fall in the real GDP for at least one quarter.

37. In studying short-run income fluctuations, potential income is usually assumed
- to be equal to actual income.
 - to be constant.
 - to be falling at its long-run average growth rate.
 - not to exist.
 - to be rising.
38. Disposable personal income is
- GNP minus that part of it not actually paid to households, minus personal income taxes paid by households.
 - personal income plus transfers, minus personal taxes paid by households.
 - equal to the gross wages received by the household.
 - GNP minus that part of it not actually paid to households, plus transfer payments to households, minus personal taxes paid by households.
 - GNP minus that part of it not actually paid to households, plus transfer payments to households.
39. To calculate GDP from the expenditure side, one must add together
- consumption, government purchases, and interest.
 - wages, profits, government purchases and net exports.
 - consumption, investment, government purchases, and net exports.
 - consumption, investment, government purchases, and exports.
 - wages, rent, interest, and profits.
40. The "circular-flow" diagram shows that producing a certain value of output gives rise to
- an equal value of claims on that output.
 - a smaller value of claims on that output, due to household saving.
 - a larger value of claims on that output, due to value added.
 - a smaller value of claims on that output, due to importing.
 - a smaller value of claims on that output, due to taxation.
41. GDP measures tend to understate the economic welfare of less-developed countries because those countries tend to
- have a large share of nonmarket activities.
 - emphasize agricultural and resource-based production.
 - import much more than they export.
 - have very high rates of pollution.
 - have a high degree of foreign direct investment.
42. If $(S+T+IM)$ exceeds $(I+G+X)$, injections _____ leakages and national output will _____ toward its equilibrium level.
- exceed, fall
 - exceed, rise
 - fall short of, fall
 - fall short of, rise

43. The multiplier can be defined as

- a) the change in equilibrium national income divided by the initial change in autonomous expenditure that brought it about.
- b) the change in national income resulting from a change in expenditure, multiplied by the number of years since the initial change.
- c) the change in national income resulting from a change in saving.
- d) national income divided by aggregate expenditure.
- e) a change in aggregate expenditures multiplied by the equilibrium level of 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 carefully why national income changes when desired aggregate expenditure does not equal national income. Sketch scenarios that fit the cases of too much and too little desired aggregate expenditure.

SOLUTION:

Graph AE-Y model.

Emphasis the role of inventories in moving the economy to equilibrium.

QUESTION II: (10 points)

Show each point on the same AD/AS graph:

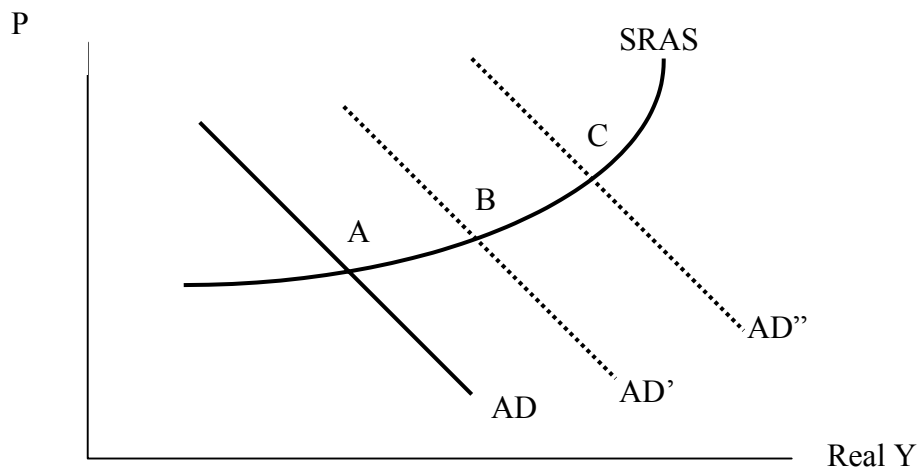
Point A: July 2001; the economy is in recession and the price level is stable.

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. e be compensated for the extra costs incurred to produce more output.
Topic: Supply Side of the Economy
2. d desired national saving exceeds desired national asset formation by an equal amount.
Topic: Equilibrium National Income
3. c 1 and 3 only
Topic: Macro Equilibrium
4. a result in an increase in both output and prices.
Topic: Macro Equilibrium
5. e disinvestment.
Topic: National Income Accounting: The Basics
6. e negative, net exports
Topic: Introducing Net Exports
7. c will overstate the real value of production.
Topic: Inflation and Interest Rates
8. e result in an increase in output but not prices.
Topic: Macro Equilibrium
9. c \$1010.
Topic: National Income Accounting: Extra Issues
10. e 100.
Topic: National Income Accounting: Extra Issues
11. a is the part of national income that is available to households to spend or save.
Topic: National Income Accounting: Extra Issues
12. b produce more only if price rises.
Topic: Supply Side of the Economy
13. c desired consumption and desired investment.
Topic: Desired VS. Actual Expenditure
14. b the inflation is fully anticipated and no one changes their behaviour.
Topic: Inflation and Interest Rates
15. a the amount by which output exceeds desired expenditures.

Topic: Equilibrium National Income

16. b inflationary pressure.
Topic: Output and Total Income
17. b buildup, lower
Topic: Equilibrium National Income
18. c plant and equipment.
Topic: Investment and AE
19. a negatively.
Topic: Demand Side of the Economy
20. e Desired aggregate expenditure is less than national income.
Topic: Demand Side of the Economy
21. e $S + (T - G)$.
Topic: Equilibrium National Income
22. b become flatter.
Topic: Equilibrium National Income
23. a below 2000.
Topic: Introducing Government
24. a If the SRAS curve is horizontal, the multiplier is infinite.
Topic: Macro Equilibrium
25. e unit costs rise at higher levels of output.
Topic: Supply Side of the Economy
26. b investment.
Topic: Equilibrium National Income
27. e we move downward along the net exports line.
Topic: Introducing Net Exports
28. c structurally unemployed.
Topic: Employment and Unemployment
29. a the greater is the unemployment rate.
Topic: Output and Total Income
30. d nominal rate of interest minus the rate of inflation.
Topic: Inflation and Interest Rates

31. b 8 percent.
Topic: Inflation and Interest Rates
32. d desired saving equals desired investment.
Topic: Equilibrium National Income
33. a exceeds income and income must rise.
Topic: Changes in Equilibrium National Income
34. a to increase the value of GDP by \$1,000.
Topic: National Income Accounting: The Basics
35. b that an increase in the price level causes consumers to substitute foreign goods for domestic goods.
Topic: Demand Side of the Economy
36. b a fall in the real GDP for at least two quarters.
Topic: Applications and Extensions
37. b to be constant.
Topic: Output and Total Income
38. b personal income plus transfers, minus personal taxes paid by households.
Topic: National Income Accounting: Extra Issues
39. c consumption, investment, government purchases, and net exports.
Topic: National Income Accounting: The Basics
40. a an equal value of claims on that output.
Topic: Output and Total Income
41. a have a large share of nonmarket activities.
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42. c fall short of, fall
Topic: Equilibrium National Income
43. a the change in equilibrium national income divided by the initial change in autonomous expenditure that brought it about.
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