

FACULTY OF BUSINESS ADMINISTRATION & ECONOMICS DEPARTMENT OF  
ACCOUNTING, FINANCE & ECONOMICS PRINCIPLES OF MACROECONOMICS

ECN 212  
EXAM 2

Fall 2008

Professor Wissam Zgheib

Date: Thursday 10/01/2008, 12:30

Duration: 50 mn

25% of Final Grade

Closed book, Problem solving, and Multiple Choice questions

1- Circle the right answer: (25 pts)

1. The marginal propensity to consume (MPC) is
  - a. the change in disposable income divided by the change in consumption
  - b. the change in consumption divided by the change in disposable income
  - c. total disposable income divided by total consumption
  - d. the change in disposable income minus the change in consumption
  - e. total consumption divided by total disposable income
2. If the government wishes to increase the level of GDP, it might
  - a. reduce taxes
  - c. reduce its purchases of goods and services
  - b. reduce the size of the budget deficit
  - d. reduce transfer payments
3. At the **break-even** level of income:
  - a. consumption is equal to saving.
  - b. the *MPC* is equal to the *MPS*.
  - c. households are borrowing more than they are saving.
  - d. the *MPS* is equal to 0.
  - e. saving is equal to 0.
4. If income increases by \$10,000, government purchases are fixed at \$1,000, investment spending is fixed at \$2,000, and the marginal propensity to consume is 0.70, by how much does aggregate expenditure increase?
  - a. \$2,000
  - b. \$700
  - c. \$1,000
  - d. \$7,000
  - e. \$1,400
5. In the short run,
  - a. spending and income are independent of one another
  - b. spending depends on income and income depends on spending
  - c. spending depends on income, but income does not depend on spending
  - d. spending is the only determinant of how much income an economy will produce
  - e. income depends on spending, but spending does not depend on income
6. Suppose that business firms change their plans and increase the total of their spending on new plant and equipment. The basic multiplier model would lead us to expect:
  - a. no change in GDP.
  - b. GDP to rise but consumer spending to fall.
  - c. GDP to fall but consumer spending to rise.
  - d. GDP and consumer spending to rise.
  - e. GDP to rise but consumer spending to be unaffected.
7. If the multiplier equals 4 and the economy is \$200 below the full employment income level, then
  - a. government should run a surplus.
  - b.  $MPS = .25$  and  $MPC = .75$ .
  - c. total spending needs to be increased by \$50.
  - d. total spending needs to be increased by \$200.
  - e. a. and b.

19. Contractionary fiscal policy includes \_\_\_ government expenditures and \_\_\_ tax revenues.

- a. increasing; increasing
- b. increasing; decreasing
- c. decreasing; increasing
- d. decreasing; decreasing

20. If the Central Bank sells \$500,000 worth of government securities, the money supply will:

- a. expand by \$500,000
- b. expand by more than \$500,000
- c. contract by \$500,000
- d. contract by more than \$500,000

21. Which of the following is a component of M2 but not of M1?

- a. Savings accounts at banks
- b. Currency
- c. Checking accounts at banks
- d. Traveler's checks

22. The sale of government bonds by a Central Bank will cause:

- a. an increase in the supply of money.
- b. an increase in the commercial banks' loans to the public.
- c. a fall in interest rates.
- d. a decrease in the reserves of the commercial banks.

23. The discount rate is the interest rate charged on

- a. third-world countries.
- b. home mortgages.
- c. a bank's loans from the Central Bank.
- d. loans that have been renewed.
- e. none of the above.

24. If taxes decrease by \$30 and the MPS is .10, then

- a. planned consumption spending will increase by \$28.
- b. planned saving will decrease by \$3.
- c. planned saving will increase by \$27.
- d. the income level will increase by \$270.
- e. the income level will increase by \$30.

25. A balanced budget occurs when the government's

- a. expenditures exceeds its tax revenues
- b. total debt equals zero
- c. expenditures are less than its tax revenues
- d. expenditures equal its tax revenues

**II- Exercise (10 pts)**

Finish the table and fill in the blanks (G = 0, T = 0, X = M).

Y	C	S	I	AD
0	50	-50	30	80
100	130	-30	30	160
200	210	-10	30	240
300	290	10	30	320
400	370	30	30	400
500	450	50	30	480

a. The economy is at equilibrium at what level of output? Y=400

b. If the full employment output is YN=300, is the economy in recession? Yes

c. If YN=300, would you favor a tax increase or a government spending increase? Government spending increase

(Those are your only choices).

d. What is the value of the Marginal Propensity to consume? 0,8

e. What is the value of the investment "multiplier"? 5

because  $S = I = 30$   
 because  $C \uparrow$  and  $S \uparrow \rightarrow AD \uparrow$   
 $\frac{210 - 130}{200 - 100} = 0,8$   
 $\frac{1}{1 - MPC} = \frac{1}{1 - 0,8} = 5$  Multiplier  
 because tax will decrease

8. When a bank helps create money, it does so by  
 a. lending its excess reserves  
 b. selling some of its investment securities  
 c. printing more checks  
 d. increasing its reserves
9. Nominal GDP, PY, is \$6 trillion. The quantity of money is \$2 trillion. Velocity is:  
 a. 12  
 b. 6 trillion  
 c. 2  
 d. 3
10. The smaller the required reserve ration,  
 a. the smaller M1 is relative to M2  
 b. None of the above  
 c. the larger the deposit multiplier  
 d. the smaller the deposit multiplier
11. The relationship between the marginal propensities to consume and to save holds that:  
 a. their sum must equal 1, since some fraction of marginal income must go to extra consumption spending and the remaining fraction to extra saving.  
 b. the point at which they are equal must be the break-even level of income.  
 c. the ratio between them must indicate the average propensity to consume.  
 d. their total must equal 0.  
 e. their total must indicate the current total of disposable income received, since  $DI$  must divide between consumption and saving.
12. Which of the following increases the multiplier?  
 a. An increase in the marginal tax rate  
 b. An increase in the marginal propensity to consume  
 c. An increase in the marginal propensity to import  
 d. An increase in the marginal propensity to save
13. During economic contractions, output  
 a. rises, but unemployment falls  
 b. and unemployment stagnate and both remain constant  
 c. and unemployment both fall  
 d. falls, but unemployment rises  
 e. and unemployment both rise
14. A budgetary surplus  
 a. means government expenditures are greater than total revenues collected.  
 b. means none of the above.  
 c. may have to be reduced to correct for unemployment.  
 d. should be incurred to correct for a recession.  
 e. will cause national income to increase.
15. In an economy with no income taxes nor imports, if the government increases its purchases by \$10 billion and increases its lump-sum taxes by \$10 billion, the  $AD$  curve  
 a. shifts leftward by \$90 billion  
 b. shifts rightward by \$100 billion  
 c. does not shift  
 d. shifts rightward by \$10 billion
16. In the simplest Keynesian model with only consumption and investment contributing to aggregate demand, if the value of the marginal propensity to consume is 0.8, then the value of the multiplier must be:  
 a. 2.5.  
 b. 5.0.  
 c. 1.6.  
 d. 4.0.  
 e. 2.8.
17. Which of the following is a liability of a bank?  
 a. Loans  
 b. Deposits  
 c. Securities  
 d. Reserves
18. To decrease the money supply the monetary authorities could  
 a. increase reserve requirements.  
 b. sell government securities on the open market.  
 c. increase the discount rate.  
 d. make fewer loans to commercial banks.  
 e. all of the above.