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FINALTERM EXAMINATION
Spring 2010
ECO401- Economics (Session - 1)

Ref No:
Time: 90 min
Marks: 69

Student Info	
StudentID:	
Center:	
ExamDate:	08 Aug 2010

For Teacher's Use Only									
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Marks									
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Q No.	17	18	19	20	21	22	23	24	
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Question No: 1 (Marks: 1) - Please choose one

Government authorities have managed to reduce the unemployment rate from 8% to 4% in a hypothetical economy. As a result:

► The economy's production possibilities curve will shift outward.
► The economy's production possibilities curve will become steeper.
► The economy will move downward along its production possibilities curve.
► **The economy will move from a point inside to a point closer to its production possibilities curve.**

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

Which of the following measures the percentage change in quantity demanded given a percentage change in consumer's income?

► Price elasticity of demand.
► **Income elasticity of demand.**
► Supply price elasticity.
► Cross price elasticity.

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

If the income elasticity of demand for boots is 0.2, a 10% increase in consumer's income will lead to a:

► 20 percent decrease in the quantity of boots demanded.
► **2 percent increase in the quantity of boots demanded.**
► 0.2 percent increase in the quantity of boots demanded.
► 20 percent increase in the quantity of boots demanded.

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

Increase in pension benefits leads to income and substitution effect which:

► Encourage workers to retire later.
► Encourage workers to work more hours.
► Have no effect on incentive to retire.
► **Encourage workers to retire earlier.**

Question No: 5 (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.

Question No: 6 (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: 7 (Marks: 1) - Please choose one

If a firm experiences economies of scale, then the:

► Long-run average total cost curve is equal to the economies of scope.
► **Long-run average total cost curve is positively sloped.**
► Long-run average total cost curve is horizontal.
► Long-run average total cost curve is negatively sloped.

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

When the marginal revenue product of labor is greater than the marginal input cost of labor then the profit maximizing firm will:

► **Hire more labor**.
► Hire less labor.
► Maintain the same employment.
► Decrease output.

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

An increase in the wage rate:

► **Will usually lead to more people employed.**
► Will decrease total earnings if the demand for labour is wage elastic.
► Is illegal in a free market.
► Will cause a shift in the demand for labour.

Question No: 10 (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: 11 (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: 12 (Marks: 1) - Please choose one

According to Keynesian economics, aggregate expenditures are the sum of desired or planned spending undertaken by:

► All four sectors only when the economy is at full employment.
► All four sectors at a specific aggregate production level.
► The household sector after taxes.
► **The business and government sectors.**

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

All of the following conditions lead to the successful operation of a cartel EXCEPT:

► 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: 14 (Marks: 1) - Please choose one

If the total product of labor per day is as shown in the table below and the price of the product is $20/unit. What is the value of the marginal product of labor (VMPL) of the 5th worker?

Labor	Total output
1	8
2	23
3	33
4	38
5	41

► 100.
► 10.
► 40.
► **60.**

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

All of the following are the reasons of downward sloping curve of aggregate demand EXCEPT:

► The exchange-rate effect.
► The wealth effect.
► **The classical dichotomy / monetary neutrality effects.**
► The interest-rate effect.

Question No: 16 (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: 17 (Marks: 1) - Please choose one

Suppose in a macroeconomic model, there is no foreign trade or government spending. In this case, aggregate demand is the sum of:

► Personal saving and private investment.

► Personal saving and personal consumption.

► Personal consumption and personal income.

► **Personal consumption and private investment**.

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

According to the quantity theory of money, which of the following is TRUE for the equation MV = PQ?

► 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: 19 (Marks: 1) - Please choose one

Potential Gross Domestic Product (GDP) measures the economy's ability to produce goods and services in which of the following conditions?

► **If labor force is fully employed.**

► If price level is stable.

► If trade balance is zero.

► If federal budget is balanced.

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

Suppose in an economy, a war destroys a large portion of a country's capital stock but the saving rate is unchanged. In this situation, the exogenous model predicts that output will grow and the new steady state will approach towards:

► 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: 21 (Marks: 1) - Please choose one

International data suggest that economies which have different steady states level will converge to:

► The steady state below the Golden Rule level.
► **The same steady state.**
► Their own steady state.
► The Golden Rule steady state.

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

Suppose there are two producers and two products. Which of the following is not TRUE in this situation?

► A producer has an absolute advantage on one product.
► **A producer has the comparative advantage on both products.**
► A producer has the comparative advantage on one product.
► A producer has an absolute advantage on both products.

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

The relationship between hours provided by labor and wage rate is:

► **Positive.**
► Negative.
► Ambiguous.
► Very strong.

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

Which of the following is equal to the number of people unemployed?

► The number of people employed minus the labor force.
► The labor force plus the number of people employed.
► The number of people employed divided by the labor force.
► **The labor force minus the number of people employed.**

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

Structural unemployment occurs:

► **With economic fluctuations; it increases during bad times and decreases during good times.**
► Because of a mismatch between the jobs that are available in the economy and the skills of workers seeking jobs.
► Naturally during the normal workings of an economy, as people change jobs, move across the country, etc.
► Because the government labels some people who aren't really in the labor force as unemployed.

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

Suppose real output in the economy increased. We would expect:

► **A decrease in unemployment.**
► A decrease in profit margins.
► An increase in unemployment.
► An increase in the natural rate of unemployment.

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

Which of the following would be expected to increase the natural rate of unemployment?

► An increase in the growth rate of the capital stock.
► A reduction in the corporate profits tax.
► **An increase in the level of unemployment compensation paid to unemployed workers.**
► A reduction in the number of new entrants into the labor force.

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

If foreign interest rate is 3% and expected depreciation is 10% then what will be the domestic interest rate?

► **3%.**
► 10%.
► 7%.
► 13%.

Question No: 29 (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: 30 (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: 31 (Marks: 1) - Please choose one

Which of the following shows the inverted-U shape when plotted on a graph?

► Consumption curve.
► Supply curve.
► Laffer curve.
► **Investment curve.**

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

In a period of recession, credit creation is:

► **Small.**

► Heavy.
► Unchanged.
► Zero.

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

LM curve shows the equilibrium in:

► Money Market.
► **Goods Market.**
► Labor Market.
► Financial Market.

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

A country has a comparative advantage:

► If it can produce a good at a higher opportunity cost than other nations.
► **If it can produce a good at a lower opportunity cost than other nations.**
► If it can produce a good by using less resources than other nations.
► If it can produce a good that lies outside its production possibilities curve.

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

Which of the following is an important feature of modern economic growth?

► **Substantial rise in product per capita.**
► Increased productivity per unit of labor input.
► Increasing use of modern scientific knowledge.
► All of the given options.

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

Suppose a consumer buys two goods X and Y. The demand for X is elastic, then a rise in the price of X will cause:

► Total spending on good Y to rise.
► Total spending on good Y to fall.
► Total spending on good Y to remain unchanged.
► **An indeterminate effect on total spending on good Y.**

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

Assume that pen and ink are complements. When the price of pen goes up, the demand curve for ink:

► Shifts to the left.
► **Shifts to the right.**
► Remains constant.
► Shifts to the right initially and then returns to its original position.

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

Which of the following will happen if two indifference curves cross each other?

► **The assumption of a diminishing marginal rate of substitution will be violated.**
► The assumption of transitivity will be violated.
► The assumption of completeness will be violated.
► Consumers will minimize their satisfaction.

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

Constant returns to scale imply that by:

► **Increasing the inputs by 1% leads to a 0.75% increase in output.**
► Increasing the inputs by 1.6% leads to a 1.5% increase in output.
► Increasing the inputs by 2% leads to a 4% increase in output.
► None of the given options.

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

Average total costs are the sum of:

► **Fixed costs and marginal costs**
► Average variable costs and marginal costs
► Average fixed costs and average variable costs
► Average marginal costs and average variable costs

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

Theory of firm is not clearly discussed & established in

► Monopoly.
► Perfect competition.
► Oligopoly.
► **None of the given options.**

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

If a 7% price reduction causes quantity demanded to rise by 10% then:

► Demand is inelastic.
► Demand is elastic.
► **Demand is perfectly elastic.**
► Total revenue will remain constant.

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

Which of the following is not a component of aggregate demand?

► Consumption spending.
► Investment expenditures.
► **Government expenditures.**
► Household income.

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

If the simple Keynesian expenditure multiplier is 2, the Marginal Propensity to Consume (MPC) is:

► 0.75
► 0.50

► 0.25
► **1.00**

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

Monetarists believed that the economy generally:

► Lies above full-employment.
► None of the given options.
► Lies below full-employment.
► **Gravitated around a full-employment.**

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

Balance of payment is an accounting record of a country's transactions with:

► South Asian countries.
► Middle East.
► **Rest of the world.**
► USA and China.

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

How an economy will be affected if money supply is increased in the country?

► Interest rate increases, investment and GDP reduces.
► Interest rate increases, investment increases and GDP reduces.
► Interest rate reduces, investment and GDP increases.
► Interest rate reduces, investment and GDP reduces.

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

The demand for money to buy bonds is called:

► Transactions demand for money.
► Precautionary demand for money.
► Speculative demand for money.
► **All of the given options.**

Question No: 49 (Marks: 3)

Mention the transactions that cause the demand for dollars to increase in the foreign exchange market.

Pakistani imports of US goods.
Pakistani travelers traveling to the US.
Pakistani students paying for study in US universities.
profits repatriated to
US by US firms operating in Pakistan.

Question No: 50 (Marks: 3)

Why countries have comparative advantage according to Ricardo?

Comparative advantage according to Ricardo:

The law of **comparative advantage** refers to the ability of a party (an individual, a firm, or a country) to produce a particular good or service at a lower opportunity cost than another party. There is a source of comparative advantage can be productivity differentials.Ricardo argued that there is mutual benefit from trade (or exchange) even if one party **(e.g. resource rich country, highly-skilled artisan**) is more productive in every possible area than its trading counterpart (e.g. resource-poor country, unskilled laborer), as long as each concentrates on the activities where it has a relative productivity advantage

Question No: 51 (Marks: 5)

A. "Slope of the consumption function is less than 1".What is meant by this statement?

When we drawn in expenditure income space, the consumption function plots as a straight line with positive intercept, and a positive but less than 1 slope.

The slope is less than 1 because not all the income is consumed some part of the income is saved.

B. What are the major macroeconomic variables involved in the determination of national income?

(Marks: 2+3)

C, I, G, X, M, T, S, prices, exchange rate, interest rate and money supply.

Question No: 52 (Marks: 5)

What are the conditions in which foreign exchange market exists? Also give some examples of foreign exchange markets.

In a market there are buyers and sellers who negotiate and agree on the price for the or price for the commodity being exchanged. The foreign exchange market is no different. whatever, here the commodity being traded is foreign exchange and the price is the foreign exchange rate. Specifically, a foreign currency is being traded for the Pakistani Ruppee at a particular rate of exchange.

The sellers and buyers of foreign exchange are not mutually exclusive. The sellers of today, may be the buyers of tomorrow, or even of today.

Foreign exchange market exists when **buyers and sellers** exit and ready to sell and buy.

The **main driving force** for foreign exchange market is the law of supply and demand.

Examples are US $-PAK RS Foregin exchange market
US $ - UK POUND Foregin exchange market

Question No: 53 (Marks: 5)

What thing determines comparative advantage among countries according to Hechshcer-Ohlin? What is the criticism against their argument?

According to Hechshcer-Ohlin suppose we are given two countries one abundant in labour and one abundant in capital and a labour-intensive good and a capital intensive good, the labour abundant country will have comparative advantage in the production of the labour-intensive good while the capital abundant country will have comparative advantage in the capital-intensive good.

So the determinants of comparative advantage among countries according to Hechshcer-Ohlin is capital goods and labour intensive goods.

Critics argued that comparative advantage can and should be viewed in a dynamic (time-varying) sense, and that it was not wise to rule out the possibility of Pakistan developing comparative advantage in cars at some future point in time.

Consequent:

The major criticism leveled against Hechscher-Ohlin type trade theories are that they views comparative advantage in an essentially static sense; i.e. if Pakistan is better at producing cotton and Japan better at producing, then this situation will always prevail.