

**FINAL TERM EXAMINATION**  
**Fall 2009**  
**ECO401- Economics**

**Time: 120 min**  
**Marks: 87**

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

The concave shape of the production possibilities curve for two goods X and Y illustrates:

- ▶ **Increasing opportunity cost for both goods.**
- ▶ Increasing opportunity cost for good X but not for good Y.
- ▶ Increasing opportunity cost for good Y but not for good X.
- ▶ Constant opportunity cost for both goods.

The shape of a production possibility curve commonly drawn as concave downward to represent increasing opportunity cost with increased output of a good.

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

When college students leave town for the summer, the demand for meals at the local restaurants decline. This results in:

- ▶ A decrease in equilibrium price and an increase in quantity of meal.
- ▶ An increase in equilibrium price and quantity of meal.
- ▶ **A decrease in equilibrium price and quantity of meal.**
- ▶ An increase in equilibrium price and a decrease in quantity of meal.

A decrease in equilibrium price and quantity. The demand curve shifts to the left because the town population declines, resulting in lower prices and quantity.

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

A demand curve is price elastic when:

- ▶ **Changes in demand are proportionately greater than changes in price.**
- ▶ Changes in demand are equal to changes in price.
- ▶ None of the given options.
- ▶ Changes in demand are proportionately smaller than changes in price.

For elastic demand curve, firm does not increase its prices. Because as prices increases, quantity Demanded decreases much larger. Decrease in quantity demanded is greater than the increase in prices. So firm will earn less revenue. So TR decreases as price increases.

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

The numerical measurement of a consumer's preference is called:

- ▶ Use.
- ▶ Pleasure.
- ▶ **Utility.**
- ▶ Satisfaction.

Utility is a numerical representation of a preference ranking

**Question No: 5 ( Marks: 1 ) - Please choose one**

**Which of the following is TRUE about price-consumption curve for good X?**

- ▶ Nominal income falls as the price of X falls.
  - ▶ The absolute price of X falls, but the relative price between X and the composite good Y stays the same.
- ▶ It is always downward sloping for a normal good.
- ▶ **It represents only those market baskets that are optimal for the given price ratio and preference pattern and therefore a demand curve can be plotted from it.**

The price consumption curve (PCC) traces out the optimal choice of consumption at different prices. The PCC can be used to derive the demand curve, which shows the relationship between price & quantity demanded.

**Question No: 6 ( 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.

marginal profit is the term used to refer to total when marginal cost is subtracted from marginal revenue.

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

**The supply curve for a competitive firm is:**

- ▶ Its entire marginal cost curve.
- ▶ The upward-sloping portion of its marginal cost curve.
- ▶ Its marginal cost curve above the minimum point of the average variable cost curve.
- ▶ **Its marginal cost curve above the minimum point of the average total cost curve.**

A perfectly competitive firm's supply curve is that portion of its marginal cost curve that lies above the minimum of the average variable cost curve.

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

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**Second-degree price discrimination is the practice of charging:**

- ▶ The reservation price to each customer.
- ▶ **Different prices for different blocks of the same good or service.**
- ▶ Different groups of customers different prices for the same products.
- ▶ Each customer the maximum price that he or she is willing to pay.

Second degree price discrimination, allows the supplier to set different prices to the different groups and capture a larger portion of the total market surplus.

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

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**A market with few entry barriers and with many firms that sell differentiated products is:**

- ▶ Purely competitive.
- ▶ A monopoly.
- ▶ **Monopolistically competitive.**
- ▶ Oligopolistic.

Monopolistic competition is also characterized by a large number of buyers and sellers and absence of entry barriers.

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

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**The market structure in which strategic considerations are most important is:**

- ▶ Monopolistic competition.
- ▶ **Oligopoly.**
- ▶ Pure competition.
- ▶ Pure monopoly.

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

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**The price elasticity of demand for any good must be less than or equal to zero unless:**

- ▶ The good is a necessity.  
A good for which the "income elasticity of demand" is  $>0$  &  $<1$
- ▶ The good is a luxury.  
A good for which the "income elasticity of demand" is  $> 1$ .
- ▶ **The good is a Giffen good.**
- ▶ None of the given options.

Goods for which the "quantity demanded" of one good does not depend upon the price of the other. (i.e. Pencils & cars). The "cross elasticity of demand" will be 0.

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

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Consumption spending, investment expenditures, government expenditures and net exports are:

- ▶ The components of household income.
- ▶ The components of aggregate supply.
- ▶ **The components of aggregate demand**
- ▶ The components of government revenue.

AD is the sum of consumption, investment, government spending and net exports (i.e. exports minus imports), and is inversely related to the aggregate price level through the wealth, interest rate and international purchasing power effects.

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

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Classical economics was replaced as the dominant theory of macroeconomic analysis by:

- ▶ Monetarism.
- ▶ Rational expectations.
- ▶ **Keynesian economics.**
- ▶ Neoclassical economics.

Question No: 14 ( Marks: 1 ) - Please choose one

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According to classical economics, the economy will always tend toward full employment due to:

- ▶ Minimum wages.
- ▶ **Flexible wages and prices.**
- ▶ Extended periods of unemployment.
- ▶ Inequality between saving and investment.

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

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The real interest rate will increase:

- ▶ **If there is an excess supply of loanable funds in the financial markets.**
- ▶ If there is an excess demand for loanable funds in the financial markets.

- ▶ If there is an excess supply of loanable funds in the foreign exchange markets.
- ▶ If there is an excess demand for loanable funds in the foreign exchange markets.

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

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**A source of fluctuations in investment spending is:**

- ▶ Changes in government expectations of future output growth.
- ▶ Changes in household's expectations about future output growth.
- ▶ Changes in household's expectations about future risk.
- ▶ **Changes in investor's expectations about future profits.**

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

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**What does the term "balance of payment deficit" refer to?**

- ▶ An increase in official international reserves.
- ▶ A positive statistical discrepancy.
- ▶ A negative statistical discrepancy.
- ▶ **A decline in official international reserves.**

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

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**M1 component of money supply consists of:**

- ▶ Paper currency and coins.
- ▶ **Paper currency, coins and check writing deposits.**
- ▶ Paper currency, coins, check writing deposits and savings deposits.
  - ▶ Paper currency, coins, check writing deposits, savings deposits and certificates of deposits.

**M1 includes currency held by the public, plus travelers' checks, demand deposits, other checkable deposits (including negotiable order of withdrawal (NOW) accounts, Automatic Transfer Service (ATS) accounts, and credit union share draft accounts).**

**Question No: 19 ( Marks: 1 ) - Please choose one**

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**When one producer can produce a given amount of output with fewer inputs, which of the following would occur?**

- ▶ Comparative advantage.
- ▶ Comparative disadvantage.
- ▶ **Absolute advantage.**
- ▶ Absolute disadvantage.

Absolute advantage.: Capability of one producer to produce a given good using fewer resources than any other producer.

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

**What would result from a depreciation of the pound on the foreign exchange market?**

- ▶ An increase in the price of imported computers.
- ▶ A fall in the purchasing power of US tourists in London.
- ▶ **A fall in the price of imported computers.**
- ▶ An increase in the purchasing power of UK tourists overseas.

A currency is said to depreciate in value if its exchange rate decreases, such as a decrease in the exchange rate of dollars from 0.5 pounds per dollar to 0.33 pounds per dollar. Currency depreciation makes exports from the country relatively less expensive resulting in more exports and usually fewer imports.

**Question No: 21 ( Marks: 1 ) - Please choose one**

**The news on the television reports that the dollar has strengthened relative to the Japanese yen. This means that:**

- ▶ The dollar can now purchase more yen.
- ▶ The US trade balance with the Japanese economy has improved.
- ▶ **The yen can now purchase more dollars.**
- ▶ The dollar has depreciated relative to the yen.

The exchange rate increases (i.e., a unit of your currency is worth more in foreign currency than previously), the currency is said to have *strengthened, appreciated, or increased in value* (revaluation). For example, assume that the exchange rate between the U.S. dollar and the Japanese yen changed from US\$1=104 yen to US\$1=110 yen. This would strengthen the value of the U.S. dollar in that you would receive more yen in exchange for your dollar

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

**In Keynesian economics, if aggregate expenditures are less than aggregate output then:**

- ▶ The price level rises.
- ▶ Inventories decrease.
- ▶ Employment decreases.
- ▶ **Aggregate output increases.**

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

**In the Keynesian cross model, the aggregate expenditure line has a slope of:**

- ▶ 1.
- ▶ 0.
- ▶ Infinity.

► **Less than 1.**

In the Keynesian cross model If we draw a graph with expenditure on the vertical axis, we can see that the Expenditure line should have a slope of ( $<1$ ),

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

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**Demand is elastic when the elasticity of demand is:**

► Greater than 0 but less than 1.

► **Greater than 1.**

► Less than 0.

► Equal to 1. unit elastic

If  $P_{ed} > 1$ , then demand responds more than proportionately to a change in price i.e. demand is elastic.

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

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**Which of the following statements is TRUE about cartels?**

► These are considered as part of monopolistic competition.

► these are organizations of independent firms, producing similar products, that work together to raise prices and restrict output.

► **these are organizations of interdependent firms, producing similar products, that work together to raise prices and restrict output.**

► These are organizations of independent firms, producing different products, that work together to raise prices and restrict output.

A cartel is a formal (explicit) agreement among firms. Cartels usually occur in an oligopolistic industry, where there are a small number of sellers and usually involve homogeneous products.

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

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**After the collusion, oligopolists are able to:**

► Raise price but not restrict output.

► Raise price and restrict output but not attain the monopoly profit.

► **Raise price and restrict output and therefore attain the monopoly profit.**

► Restrict output but not raise price.

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

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**Which of the following statements is TRUE about the difference between nominal and real Gross Domestic Product (GDP)?**

► Real GDP includes only goods; nominal GDP includes goods and services.

► **Real GDP is measured using constant base-year prices; nominal GDP is measured using current prices.**

- ▶ Real GDP is equal to nominal GDP less the depreciation of the capital stock.
- ▶ Real GDP is equal to nominal GDP multiplied by the CPI.

Nominal GDP: The total market value, measured in current prices,

Real GDP: The total market value, measured in constant prices

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

**If production remains the same and all prices double, then which of the following will happen?**

- ▶ Real GDP and nominal GDP will both remain constant.
- ▶ Real GDP will remain constant and nominal GDP will reduce by half.
- ▶ **Real GDP will remain constant and nominal GDP will double.**
- ▶ Real GDP will double and nominal GDP will remain constant.

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

**Assume that there is no government or foreign sector, if the marginal propensity to consume (MPC) is 0.9, then the value of multiplier will be equal to:**

- ▶ 2.
- ▶ 5.
- ▶ 8.
- ▶ 10.

**NO IDEA... MAY BE WRONG QUESTION**

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

**Firm A produces cotton worth Rs. 1000 and sells it to firm B. From this, firm B makes yarn worth Rs. 1500 and sells to firm C. Firm C manufactures cloth worth Rs. 2500 and sells to consumers. The value added is:**

- ▶  **$1000+1500+2500 = \text{Rs. } 5000$**
- ▶  $1000+500+2500 = \text{Rs. } 4000$
- ▶  $1000+500+1000 = \text{Rs. } 2500$
- ▶  $1000+1500+1000 = \text{Rs. } 3500$

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

**Which of the following is a transfer payment?**

- ▶ Payment made to housewife.
- ▶ Pocket allowance to children.
- ▶ Maintenance allowance to old parents.
- ▶ **All of the given options.**

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

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

- ▶ **Positive.**
- ▶ Negative.
- ▶ Ambiguous.
- ▶ Very strong.

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

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Market failure occurs when:

- ▶ Competitive markets do not achieve equitable outcomes.
- ▶ Competitive markets do not achieve efficient outcomes.
- ▶ Government takes steps to intervene in markets.
- ▶ **All of the given happen.**

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

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A graph that depicts the relationship between the total quantity of goods and services demanded and the price level is known as:

- ▶ **Aggregate demand curve.**
- ▶ Average price level.
- ▶ Circular flow model.
- ▶ GDP curve.

The aggregate demand curve illustrates the relationship between economic goods demanded and the price level, assuming all else is held constant (that is, under *ceteris paribus* assumption).

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

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In the short run, the equilibrium price level and the equilibrium level of total output are determined by the intersection of:

- ▶ The aggregate demand, the short-run aggregate supply and the long-run aggregate supply curves.
- ▶ The short-run aggregate supply and the long-run aggregate supply curves.
- ▶ The aggregate demand and the short-run aggregate supply curves.
- ▶ The aggregate demand and the long-run aggregate supply curves.

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

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Changes in aggregate demand can be caused by changes in:

- I. Wages.
- II. Raw materials costs.

III. **Government spending.**

IV. **Government regulations that increase the cost of doing business.**

▶ I, II, III, and IV.

▶ I and III only.

▶ I, III, and IV.

▶ **III only.**

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

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**In the long run, the output level is determined by:**

▶ Aggregate demand.

▶ **Aggregate supply.**

▶ The government.

▶ Household income.

**Long run aggregate supply (LRAS):** LRAS shows total planned output when both prices and average wage rates can change - it is a measure of a country's potential output and the concept is linked strongly to that of the **production possibility frontier**

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

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**Which of the following is TRUE?**

▶  **$1 - \text{MPS} = \text{MPC}$**

▶  $1 + \text{MPS} = \text{MPC}$

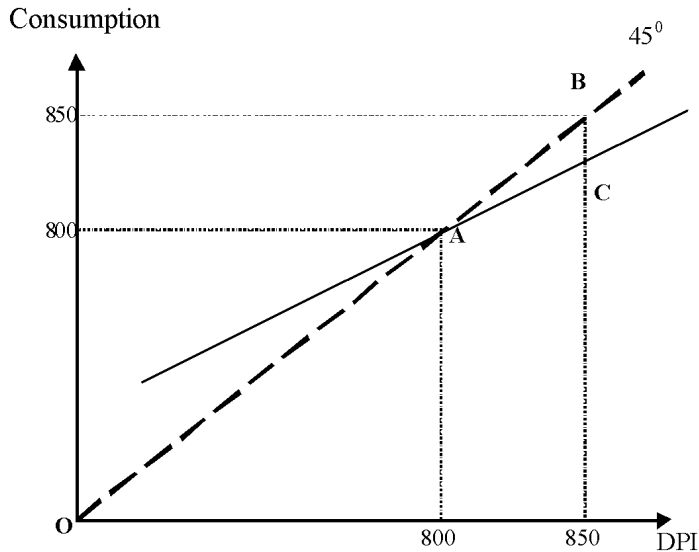
▶  $1 / \text{MPS} = \text{MPC}$

▶  $1 \times \text{MPS} = \text{MPC}$

**(MPS) is the fraction of the additional dollar of disposable income that is Saved. Thus,  $\text{MPC} = 1 - \text{MPS}$ .**

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

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The above figure shows disposable personal income on the horizontal axis and consumption per period on the vertical axis. Which of the following is **TRUE** at every point on the 45-degree line?

- ▶ The value of disposable income equals the sum of personal saving and consumption.
- ▶ The value of disposable income equals consumption.
- ▶ The value of disposable income equals personal saving.
- ▶ The value of disposable income and consumption equals 1.

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

If the government wishes to achieve a fall in unemployment, which of the following policies should it adopt?

- ▶ Reduce the real value of income tax free allowances.
- ▶ Reduce government spending on capital projects.
- ▶ Raise Value Added Tax (VAT).
- ▶ **Start public job training programs.**

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

In the long run, sustained inflation is due to:

- ▶ A one-time increase in money growth.
- ▶ **A continuous increase in the money growth rate.**
- ▶ A continuous increase in aggregate demand.
- ▶ The rising price of oil.

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

The situation when a country imports more than it exports is known as:

- ▶ **A trade deficit.**
- ▶ A trade surplus.
- ▶ An expansion.

- ▶ A recession.

**A negative balance of trade, i.e. imports exceed exports. opposite of trade surplus.**

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

**Public investment expenditure for highways, schools, and national defense is included in which component of GDP?**

- ▶ Consumption.
- ▶ Gross private investment.
- ▶ **Government purchases.**
- ▶ Public investment.

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

**The government has a balanced budget if:**

- ▶ **Its total revenues are equal to its total expenditures.**
- ▶ Its total revenues are less than its total expenditures.
- ▶ Its total revenues are greater than its total expenditures.
- ▶ The money supply is less than total expenditures.

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

**In general, personal income taxes:**

- ▶ Rise automatically during a recession.
- ▶ **Rise automatically during an expansion.** Not sure
- ▶ Fall automatically during an expansion.
- ▶ Remains same in all phases of economic fluctuations.

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

**A tax on individual's income is known as:**

- ▶ Sales tax.
- ▶ . Excise tax
- ▶ Corporate income tax.
- ▶ **Personal income tax.**

**Personal income tax:** A tax on individual income. This is the primary source of revenue for the federal government, a big source for many state and local governments. In principle, personal income taxes are progressive, based on a graduated tax scale. However, it's much more proportional today than it was several decades ago.

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

**Which of the following is TRUE for banks?**

- ▶ **They deal with money only.**
- ▶ They deal with shares and assets.
- ▶ They not only deal with money but also create money.

- ▶ They deal with money but do not create money.

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

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**In a period of boom, credit creation is:**

- ▶ Small.
- ▶ **Heavy.**
- ▶ Unchanged.
- ▶ Zero.

**Question No: 49 ( Marks: 1 ) - Please choose one**

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**What will be the impact of an increase in taxes?**

- ▶ It will shift the IS curve to the left and decrease both the interest rate and the level of income.
- ▶ It will shift the IS curve to the right and increase both the interest rate and the level of income.
- ▶ It will shift the IS curve to the right and increase the level of income but decrease the interest rate.
- ▶ **It will shift the LM curve downward (to the right) and increase the level of income but decrease the interest rate.** Not sure

**Question No: 50 ( Marks: 1 ) - Please choose one**

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**To determine whether an economy's output is growing or shrinking, one must keep track of:**

- ▶ Changes in nominal GDP.
- ▶ Changes in the growth rate of nominal GDP.
- ▶ Changes in the general price level.
- ▶ **Changes in real GDP.**

Economic growth is increase in an economy's level of production, output or income. We can talk about production or output in two broad definitional contexts. One, we can compare real GDP with some other measure of welfare (for e.g., one which adjusts for externalities, social indicators, the black market, purchasing power parity, income inequality etc.).

**Question No: 51 ( Marks: 1 ) - Please choose one**

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**Suppose the price of rail tickets decreases, what will happen to the demand for airline travel?**

- ▶ **The demand curve for airline travel shifts left.**
- ▶ The demand curve for airline travel shifts right.
- ▶ The supply curve of airline travel shifts left.
- ▶ The supply curve of airline travel shifts right.

The demand curve shifts left. Rail and airline travel are substitutes. If the price of a substitute declines, then the demand curve for the substitute product shifts to the left.

**Question No: 52 ( Marks: 1 ) - Please choose one**

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**Production possibilities curve will shift upward if there is:**

- ▶ A reduction in unemployment.
- ▶ **An increase in the production of capital goods.**
- ▶ A reduction in discrimination.
- ▶ All of the given options.

**Question No: 53 ( Marks: 1 ) - Please choose one**

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**Which of the following is NOT included in the perfect information assumption of perfect competition?**

- ▶ Consumers know their preferences.
- ▶ Consumers know their income levels.
- ▶ Consumers know the prices available.
- ▶ **Consumers can anticipate price changes.**

**Question No: 54 ( Marks: 1 ) - Please choose one**

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**Suppose a monopolist set his output at the level where marginal revenue, marginal cost and average total cost are equal. In this case, economic profit will be:**

- ▶ Negative.
- ▶ **Positive.**
- ▶ Zero.
- ▶ Indeterminate from the given information.

As profit is maximized at the point where  $MR = MC$ ,  
Depending upon the level of **AC at the point where  $MR=MC$** , the monopolist might be  
earn supernormal profits, breaking even or minimizing short run losses.

**Question No: 55 ( Marks: 3 )**

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**Differentiate between the terms flow and stock.**

Stocks and those which are flows; these differ in their units of measurement. A stock variable is measured at one specific time, and represents a quantity existing at that point in time, which may have been accumulated in the past. A flow variable is measured over an interval of time. Therefore a flow would be measured per unit of time.

Stocks and flows have different units and are thus not commensurable – they cannot be meaningfully compared, equated, added, or subtracted. However, one may meaningfully take ratios of stocks and flows, or multiply or divide them.

**Question No: 56 ( Marks: 5 )**

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**What should be the optimal role of government in an economy according to the Classical school of thought? Discuss.**

**Question No: 57 ( Marks: 5 )**

**Explain the difference between current account and capital account.**

**Current account :**

Current account is one of the two primary components of the balance of payments, the other being the capital account. It is the sum of the balance of trade (exports minus imports of goods and services).

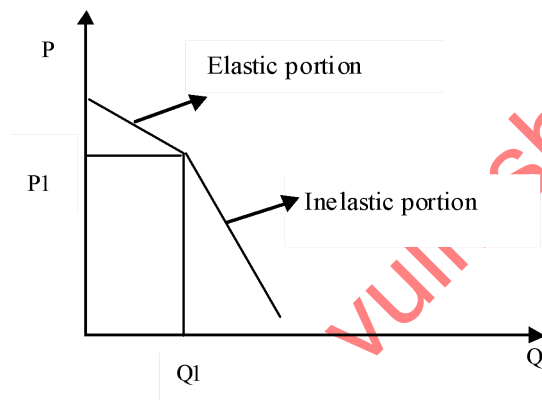
**Current account = balance of trade + net factor income from abroad + net unilateral transfers from abroad**

Current account deals with international trade in goods and services and with earnings on investments.

**Capital account:**

The capital account consists of capital transfers and the acquisition and disposal of non-produced, non-financial assets. A subdivision of the capital account, the financial account records transfers of financial capital and non-financial capital. The official reserves account, which is part of the financial account, is the foreign currency held by central banks, and is used to pay balance-of-payment deficits. Each account is further divided into sub-accounts.

**Question No: 58 ( Marks: 10 )**



(A) The above demand curve has two distinct segments which have different elasticities that join to form a corner or kink. Why the firms are reluctant to change the price in these two segments?

(B) What are the major advantages that an oligopoly offers for public interests?

**(Marks: 5+5)**

**Question No: 59 ( Marks: 10 )**

**The items of balance sheet of State Bank of Pakistan are given as follows:**

Forex reserves = Rs. 500

Notes and coins = Rs. 800

Credit to government = Rs. 200

Government and commercial bank deposits = Rs. 300

Credit to private sector = Rs. 700

Liquidity paper = Rs. 300

**Prepare the balance sheet in its proper format of asset and liabilities side.  
Also calculate total assets and total liabilities.**

**Solution: (this question solved by kash again)**

<b>Assets</b>	<b>Liabilities</b>
Forex reserves = Rs. 500	Government and commercial bank deposits = Rs. 300
Credit to government = Rs. 200	Notes and coins = Rs. 800
Credit to private sector = Rs. 700	Liquidity paper = Rs. 300
<b>Total= RS 1400</b>	<b>Total= RS 1400</b>