SAMPLE EXAM QUESTIONS FOR FALL 2017 ECON3310 MIDTERM 1

2 sections. In first section answer 3 out of 4 for 10% each.   In second section answer 35 multiple choice questions for 2% each.

PART I.
Short questions: 3 out of 4 (30% of total marks)

1. Assume that the typical household behaves according to Irving Fisher's two-period model, that consumption in both periods is a normal good, and that households are initially savers. Illustrate graphically how a tax cut in period one affects consumption in both periods. Assume that the average consumer does not believe that he or she or anyone in the family will ever have to pay higher taxes in the future to offset the current cuts.

2. a. Suppose a government moves to reduce a budget deficit. Using the long-run model of the economy developed in Chapter 3, graphically illustrate the impact of reducing a government's budget deficit by reducing government purchases. Be sure to label: i. the axes; ii. the curves; iii. the initial equilibrium values; iv. the direction curves shift; and v. the terminal equilibrium values.
   b. State in words what happens to: i. the real interest rate; ii. national saving; iii. investment; iv. consumption; and v. output.

PART II.
Multiple choice questions: 35 questions with no choice (70% of total marks)

3. Endogenous variables are:
   A)   fixed at the moment they enter the model.
   B)   determined within the model.
   C)   the inputs of the model.
   D)   from outside the model.

4. Which of the following is a stock variable?
   A)   Wealth
   B)   Consumption
   C)   Investment
   D)   Income

5. John Maynard Keynes believed that:
   A)   consumers would save more if the interest rate was high.
   B)   consumers would consume more if the interest rate was high.
   C)   if consumers consume less, the interest rate will be high.
   D)   the interest rate is relatively unimportant to the consumption decision.

6. According to the life-cycle model, the average propensity to consume does not fall as income increases in the long run because:
   A) wealth and income grow together.
   B) as income increases wealth decreases.
   C) saving is constant over the life cycle.
   D) wealth is constant over the life cycle.

7. Net investment is the:
   A) business fixed investment minus inventory investment.
   B) change in the stock of capital.
   C) gross investment minus the rate of inflation.
   D) gross investment plus the replacement of depreciated capital.

8. The theory behind Tobin's q indicates that:
   A) the stock market may be expected to predict every turning point in real GDP.
   B) the stock market may be expected to be closely tied to fluctuations in output and employment.
   C) every time investment goes up we would expect the stock market to go down.
   D) the stock market and the economy are basically independent of each other.

9. Holding other factors constant, a decline in the real interest rate will _____ the price of housing and _____ the flow of residential housing investment.
   A) increase; increase
   B) increase; decrease
   C) decrease; increase
   D) decrease; decrease

10. The opportunity cost of holding inventories is the:
    A) real interest rate.
    B) nominal interest rate.
    C) raw materials used up in the production of inventories.
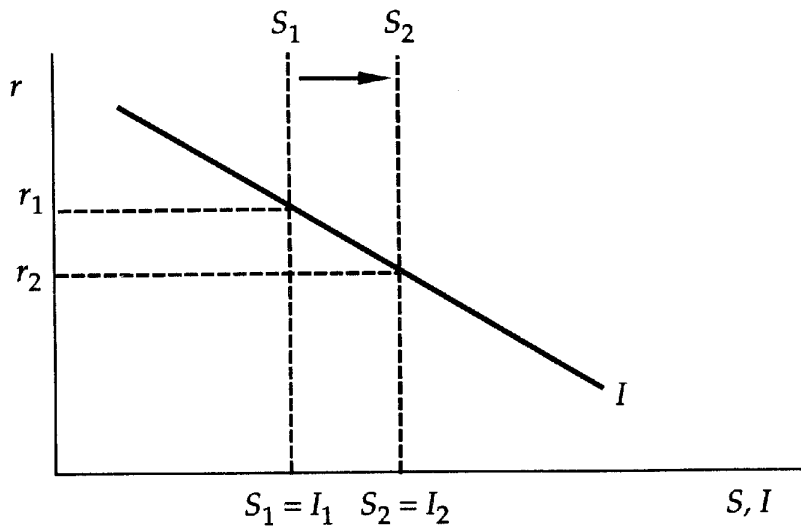   D) labor used in the production of inventories.

Answer Key

Longer questions

1.

$$(1+r)(Y_1+T_1)+Y_2$$

$$(1+r)Y_1+Y_2$$

B

C_2'

C_2 .... A

Y_2

C_1 C_1' Y_1 $Y_1+Y_2/(1+r)$ $Y_1+T_1+(Y_2/(1+r))$
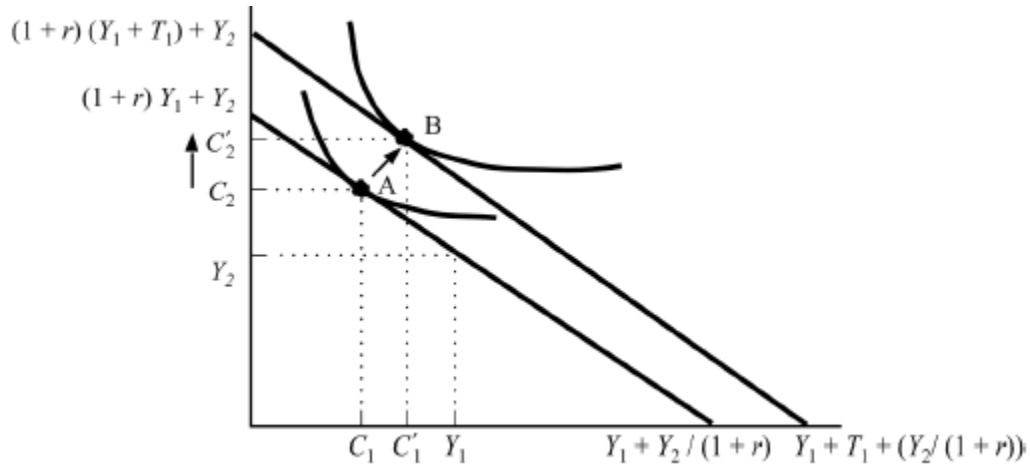
Consumption in both periods one and two increases.

2. a.

S_1 S_2

r

r_1

r_2

I

$S_1=I_1$ $S_2=I_2$ S,I

b.   i.   real interest rate decreases
     ii. national saving increases
     iii. investment increases
     iv. consumption is unchanged
     v.   output is unchanged, fixed because it is determined by the factors of
          production

<u>Multiple Choice</u>

1. B
2. A
3. D
4. A
5. B
6. B
7. A
8. A
9. B
10. B