Questions on Macroeconomics

Chapter - Determination of Income and Employment

1 mark questions

Q. The primary reason that we are interested in consumer sentiment is that sentiment helps predict future ____, which affects ____ in the ____ direction.

a. Autonomous consumption; consumer happiness; same
b. Exports; GDP; same
c. Autonomous consumption; GDP; same
d. Investment; GDP; opposite

Q. Suppose there is a partial central government shutdown. Many government employees had difficulty covering their living expenses as soon as they missed one paycheck. This episode suggests that there are likely to be large differences across consumers in their:

a. Willingness to work

b. Autonomous consumption and marginal propensities to consume

c. Attitudes toward government policies

d. Effective tax rates

3 marks question to be answered in 60-80 words

Q. “The equilibrium level of output determined by the equality of Y with AD always means full employment of resources.” True, False, Uncertain. Discuss.

A. False.

The equilibrium level of output is when the quantity of output produced is equal to the quantity demanded. This output level may be less or more than the level of output at which all resources are employed, also called, full employment level of income. If the equilibrium level of output is less than the full employment level of income, it is because there is not enough demand to employ all the factors of production. On the other hand, if the equilibrium level of output is more than the full employment level of income, it is because of demand being more than the quantity of output produced at the full employment of resources.

4 marks question to be answered in 80-100 words

Q. Discuss two factors each that impact the consumption and investment and hence AD in an economy?

A. Two factors affecting consumption are:

1. Income taxes – An increase in income taxes, decreases the disposable income, which further decreases our consumption spending. A fall in consumption spending finally decreases AD in the economy.

2. Consumer confidence – If consumers are confident about economy and hence their job in future, they will increase the spending on consumption. This in turn increases AD.

Two factors affecting investment are:

1. Interest rates – A lower interest rate means cheaper cost of borrowing for businesses to expand. Therefore, they increase their investment that increases AD in the economy.
2. Corporate taxes – A rise in corporate taxes decreases after-tax profits of businesses. This leaves them with less money for business investment spending, thereby decreasing AD in the economy.

6 marks question to be answered in 100-150 words

Q. In Tigerland, consumers spend according to the equation:

C = 100 + 0.8 Y, while investment is given by I = 50

(a) What is the equilibrium level of income in this case? (2)
(b) What is the level of saving in equilibrium? (1)
(c) If I rise to 100, what will the effect be on the equilibrium income? (2)
(d) What is the value of the multiplier here? (1)

A. (a) At equilibrium:

AD = Y where AD = C+I

Therefore, we get

C+I =Y

Substituting the consumption function and investment value, we get:

Y = 100 + 0.8Y + 50

Y- 0.8Y = 150

0.2 Y = 150

Y = 150/0.2 = 750

Thus, the equilibrium level of income is 750.

(b) S = Y-C

Substituting the value of equilibrium level of income in the consumption function, we get

C = 100 + 0.8 (750)

= 100 + 600

= 700

Therefore, S = 750 – 700

S = 50

(c) ΔY/ ΔA = 1/ (1-c) where

ΔY = change in equilibrium income

ΔA = change in autonomous expenditure. In this case, it is the change in investment.

c = marginal propensity to consume

ΔY = ΔA / (1-c)

= (100-50) / (1-0.8)

= 50 / 0.2

= 250

Therefore, new equilibrium = Old equilibrium + ΔY

= 750 + 250

= 1000

(d) Multiplier = 1 / 1-c

= 1 / 1-0.8

= 1 / 0.2

= 5