Econ 102
Midterm Exam

Note: Total time - 50 minutes
Answer both Part A and Part B
Part A and Part B are of equal value

USE TWO EXAM BOOKS, ONE FOR PART A AND PART B.
ON EACH EXAM BOOK PRINT YOUR NAME AND YOUR TA'S NAME

PART A (25 minutes)

Below are 4 pairs of concepts or ideas. Define or explain briefly (that is, in no more than one or two sentences) EACH member of a pair, and then explain the relationship between the two.

(1) a demand curve AND factors causing a demand curve to shift to the right.

(2) Malthusian positive checks AND the law of diminishing returns.

(3) Keynesian assumption about "sticky" wages (or rigidity in wages) AND unemployment.

(4) transactions which count as gross domestic product transactions AND the output approach (or "value added" approach) to measuring GDP.

OVER
Consumers in a small shiekdom (with no exports or imports) always spend $500 million plus 50% of income received, or

\[ C = 500 + 0.5(Y-Tx). \]

The government has a tradition of a balanced budget, and at present

Government spending = G = 400

Taxes = Tx = 400.

Investment spending is not affected by changes in income, or in the symbols used in our model building

\[ I = \bar{I} \]

a. What is the marginal propensity to consume?

b. If the equilibrium level of income (Y) is $2400 million, at that income level what is desired investment? (Show all your work.) What are the three kinds of investment?

c. The Sultan wants "to stimulate" the economy of his shiekdom, and accordingly issues an executive order to increase government spending by $300 million (without any tax increase). If this spending takes place, using the concept of circular flow, show the first three resulting changes in income (\( \Delta Y \)). What will determine whether or not this increased spending will create pressures for wages and prices to rise?

d. The parliament of the shiekdom is appalled by this departure from their balanced budget tradition, and accordingly passes a law that any increases in income (above the equilibrium level of $2400 million) will be taxed at a 50% rate. (Thus, if your income goes up by $20, the government takes away $10.) Assuming this law goes into effect before the Sultan acts, now when government spending increases by $300 million, what will be the first three resulting increases in income (\( \Delta Y \))? What will be the new equilibrium level of income? Again, show all your work.