edge Business School

ECS 1601

EXAM PACK

LECTURER:

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2ND SEMESTER 2018

Integrity • Responsibility • Passion • Community • Legacy

ECS1601 EXAM PAPER MAY/JUNE 2018 SECTION A (50 MARKS)

ANSWER ALL THE FOLLOWING QUESTIONS

QUESTION 1

(i) Define the Gross Domestic Product (GDP) (3)

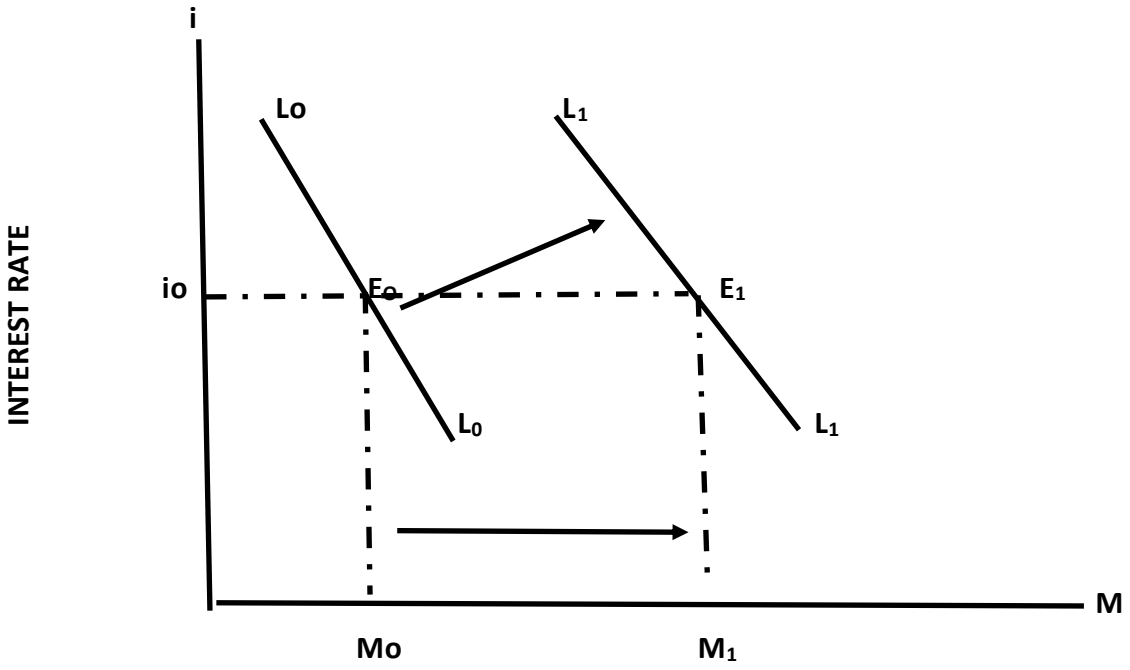
GDP is the total values of all the final goods and services produced within the borders of a country within a specific period.

(ii) Name the four factors of production (4)

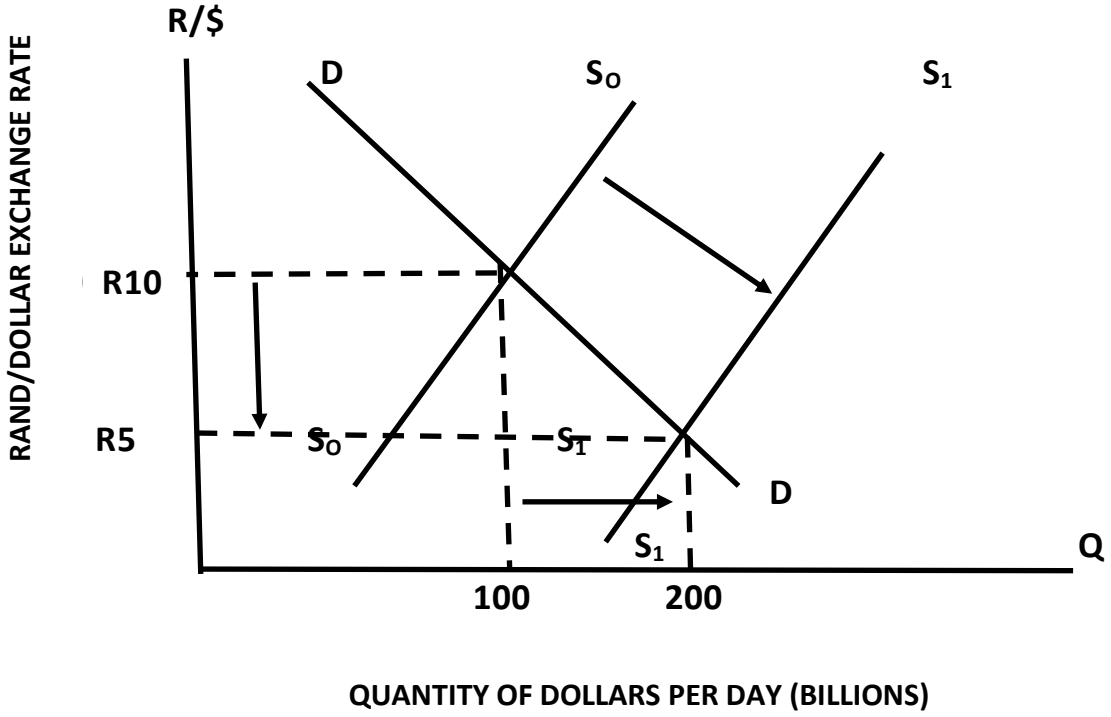
Land (Natural resources), Labour, Capitl and Entrepreneurship

QUESTION 2

(i) Use the following diagram to show the equilibrium in the money market changes if the level of income in the economy increases. Remember to label your diagram (3)



(ii) Illustrate on the following diagram of the South African foreign exchange market what will happen to the exchange rate between the rand and the US dollar if South Africa implements export promotion measures. Remember to label your graph. (3)



(iii) Suppose the Minister of Finance has asked you to advise him on the formulation of a tax policy. Write a paragraph that will explain what your major consideration will be when you design this tax policy (9)

Because tax is a particularly sensitive and political issue it is important the there is a tax policy which includes a fair and acceptable way to run the tax system that is accepted by all the stakeholders. Adam Smith points out that that there should be four cannons or criteria for taxation. A good tax should be equitable, economical, convenient and certain. The text book distinguishes between three slightly more modern criteria.

(i) **Neutrality**: Taxation should have the minimum possible effect on relative prices. There should be no disincentive to change the owners of the factors of production to change their behaviour due to high taxes.

(ii) **Equity**: To determine what is equitable or fair or who should pay taxes, two principles can be used:

1) **Ability to pay principle:** People should pay according to their ability (level of income). There are two notions of equity **horizontal equity** (people in the same position should pay the same tax) and **vertical** equity (people n different positions should be taxed differently)

2) **Benefit principle:** The people who use the government products and services should pay for this use. These are also called **user charges,** (toll roads, hospital services, university educations and electricity and water)

3) **Administrative simplicity:** Taxes cost taxpayers. **Compliance costs:** taxpayers have to fill out forms and pay accountants to do this for them. **Administrative costs:** People have to be employed by government to write up tax laws, design tax forms, and collect taxes and asses tax returns.

- **Also note: tax avoidance:** This is the practice of avoiding paying taxes (it is legal but lowers the tax revenue for the government)
- **Tax evasion:** This occurs when people do not pay taxes when they should (vendors at flea markets or people who run their businesses from home e.g. hairdressers' or dressmakers)

QUESTION 3

Given the following information:

INCOME (RANDS)	CONSUMPTION (RANDS)	SAVINGS (RANDS)	INVESTMENT (RANDS)
0	10	-10	20
50	50	0	20
100	90	10	20
150	130	20	20
200	170	30	20

(a) Calculate (Show all your calculations)

(i) The marginal propensity to consume (2)

$$MPC = \frac{\Delta C}{\Delta Y}$$

$$\frac{170 - 130}{200 - 150}$$

$$\frac{40}{50}$$

$$MPC = 0.80$$

(ii) The marginal propensity to save (2)

$$MPS = 0.20$$

(iii) The multiplier (2)

$$\alpha = \frac{1}{1 - c}$$

$$\alpha = \frac{1}{1 - 0.80}$$

$$\alpha = \frac{1}{0.20}$$

$$\alpha = 5$$

(iv) The equilibrium level of income

$\overline{A} = C + I = 10 + \overline{20} = \overline{\quad}$

YOU HAVE TO FIND AUTONOMOUS CONSUMPTION

$Y_o = \alpha A$

$Y_o = 5 \times 30$

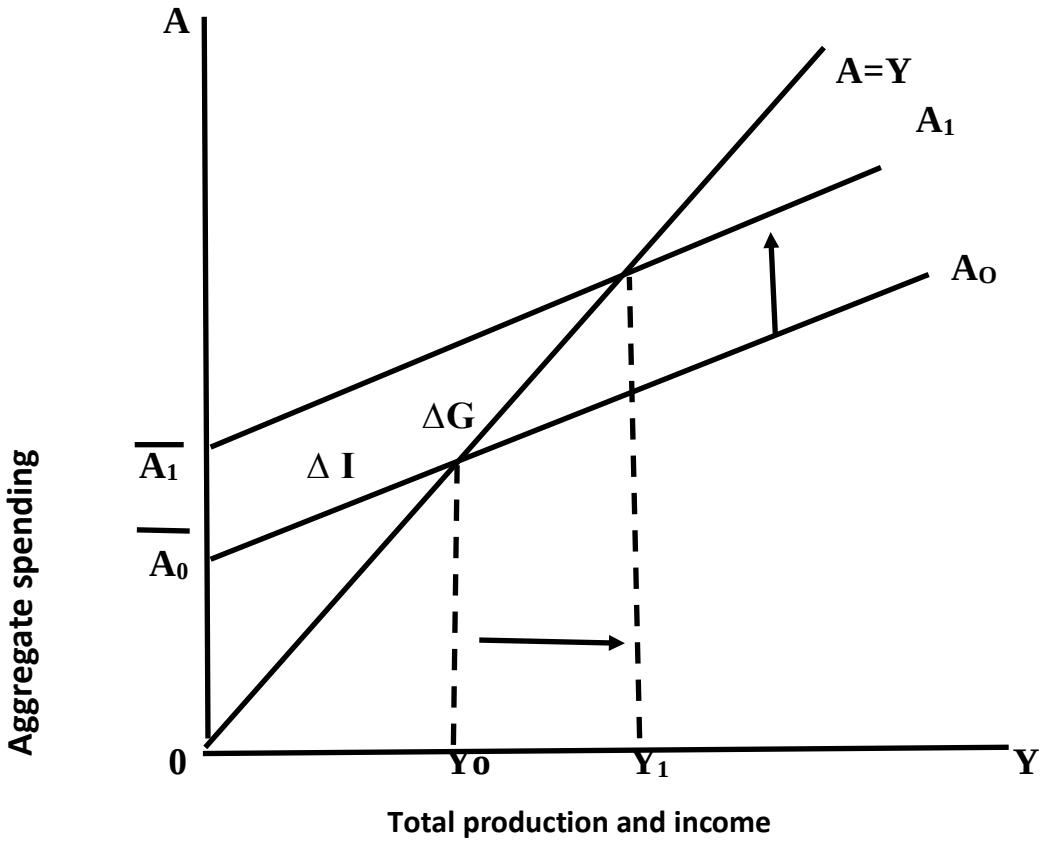
$Y_o = 150$

$C = \overline{C} + cY$

$170 = X + 0.80 \times 200$

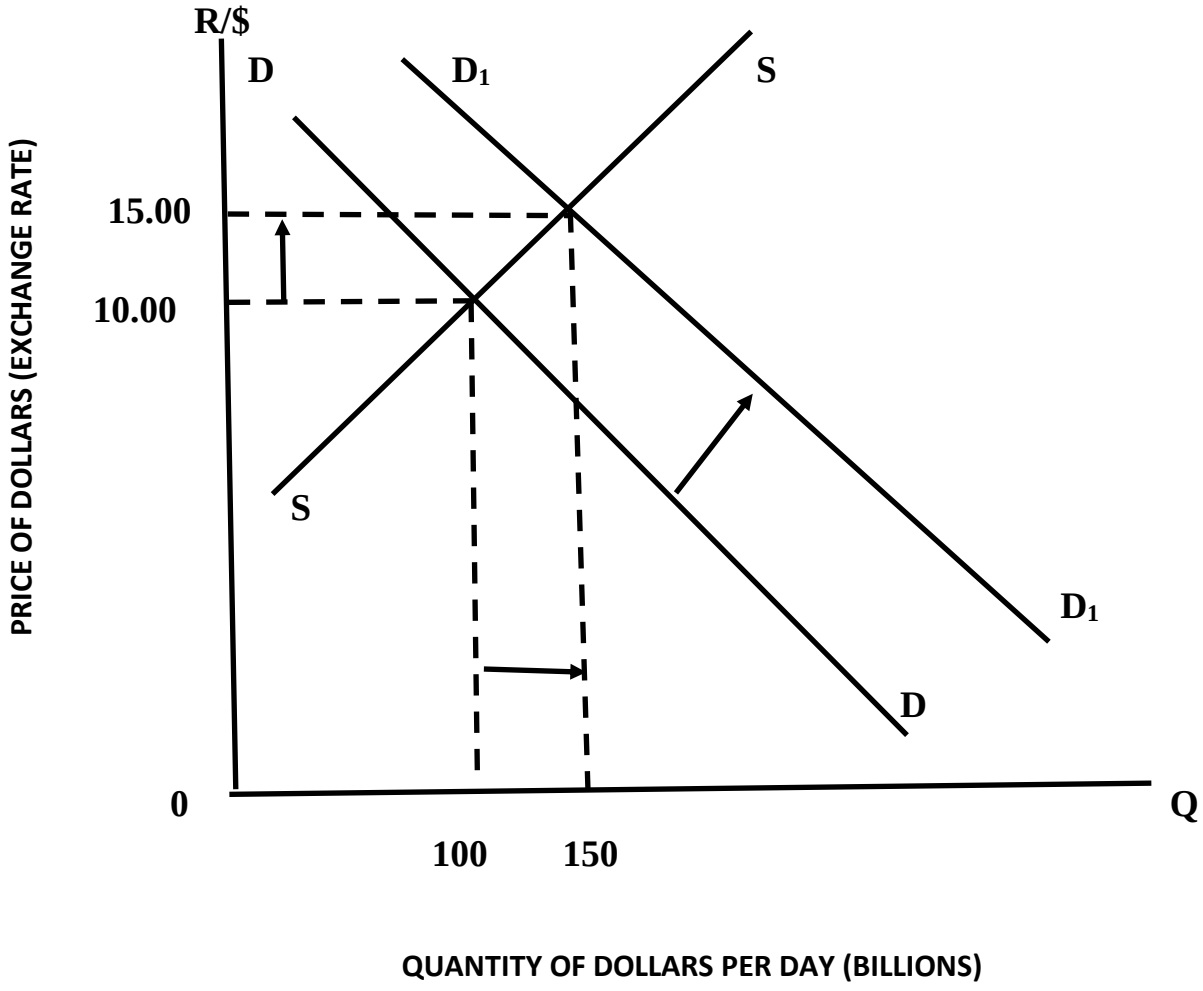
$170 = 10 + 160$

(b) Demonstrate, using the Keynesian model, how unemployment can be reduced in the economy (3)



QUESTION 4

(i) Suppose that there is an increase in the amount of goods that South Africa imports from the United States. Explain how this would affect the equilibrium exchange rate (R/$) in South Africa (3)



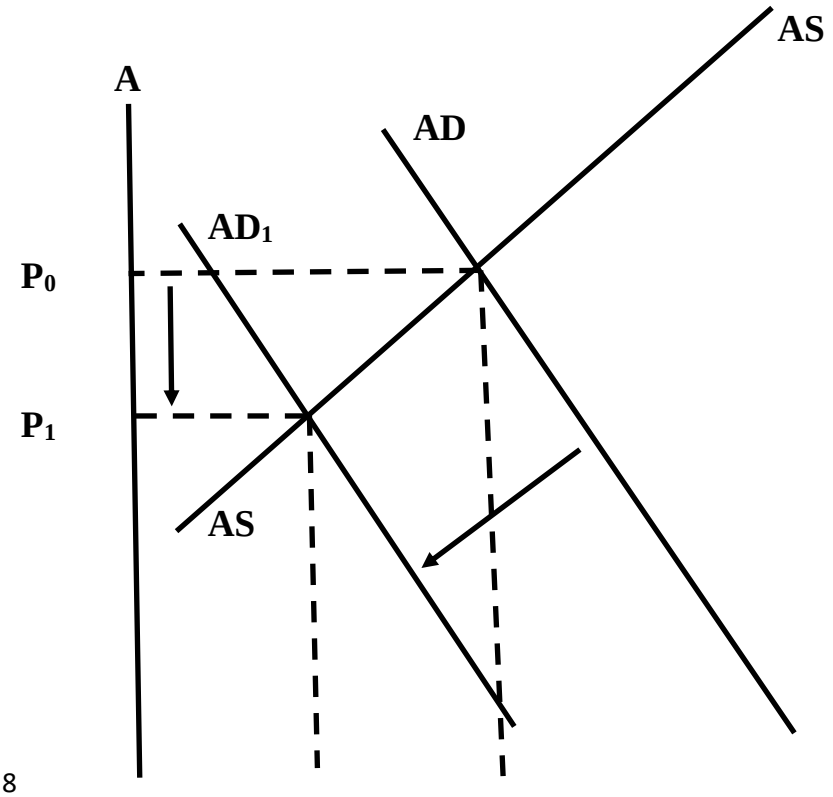
When USA imports increase in South Africa, the demand dot dollars increase. The demand curve for dollars increases and shifts to the right from DD to D_1D_1. The equilibrium for quantity increases from 100 to 150. The price of the dollar has increase from R10.00 to R15.00 so this means that the rand has depreciated against the dollar.

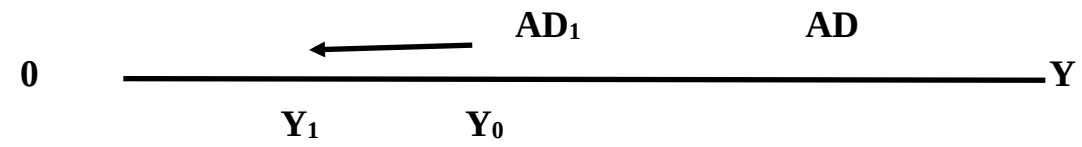
(ii) Distinguish between active balances and passive balances and mention the main determinants of the quantity demanded of each. (4)

The demand for active balances represents the **transaction** demand for money. The purpose of money in this instance is to spend the money.

The demand for passive balances refers to the **speculative** demand for money. The purpose of money in this instance is to hold the money passively as a store of value

(iii) Use the AD-AS model to explain how an increase in the tax rate will affect the economy (5)





With an increase in taxes our disposable income decreases (impacts on consumption curve). The ADAD curve shifts to the left to AD_1AD_1. Total Production and Income decreases from Y_0 to Y_1 (an increase in unemployment). The price has decreased from P_0 to P_1. Inflation has decreased but at the expense of higher unemployment.

(iii) Explain why policy makers cannot solve the stagnation dilemma using only demand management policies. (5)

Policy makers cannot solve the stagnation dilemna with demand management because

(i) If the policy makers want to stimulate the economy due to stagnation if they either increase government spending and/or reduce taxes (fiscal policy) or decrease interest rate (monetary policy) Total/Production and Income will increase but prices will go up which means that there will be higher inflation.

(ii) If the policy makers want to restrict or contract the economy due to high inflation or to reduce inflation they can decrease government spending and/or increase taxes(fiscal policy) or increase the interest rate (monetary policy). The problem here is that inflation (prices will decrease) will come down but at the expense of higher emoloyment.

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QUESTIONS	ANSWERS
1	4
2	3
3	3
4	3
5	4
6	3
7	2
8	1
9	2
10	2
11	2
12	3
13	3
14	2
15	2
16	2
17	2
18	1
19	2
20	2
21	1
22	3
23	1
24	2

25	**2**
26	**2**
27	**4**
28	**3**
29	**2**
30	**1**

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QUESTION 1 **(12)**

1(a) List the three withdrawals from the circular flow of income and spending (3)

(i) Savings

(ii) Taxes

(iii) imports

1(b) Price stability is one of the macroeconomic objectives. List four other objectives

(i) Full employment

(ii) Economic growth

(iii) Distribution of income

(iv) Manage the Balance of payments

(4)

1(c) Explain the difference between gross domestic product (GDP) and the gross national income (GNI) (2)

Gross Domestic product is the value of the final goods and services produced within the borders of a country in a specific period.

Gross National Income is Gross Domestic Product minus all income earned by foriegners within the borders of a country (SA) and plus all the incoe earned by South African citizens earning outside the borders of the country (SA)

1(d) In the table below, provide any three differences between the consumer price index and the producer price index (3)

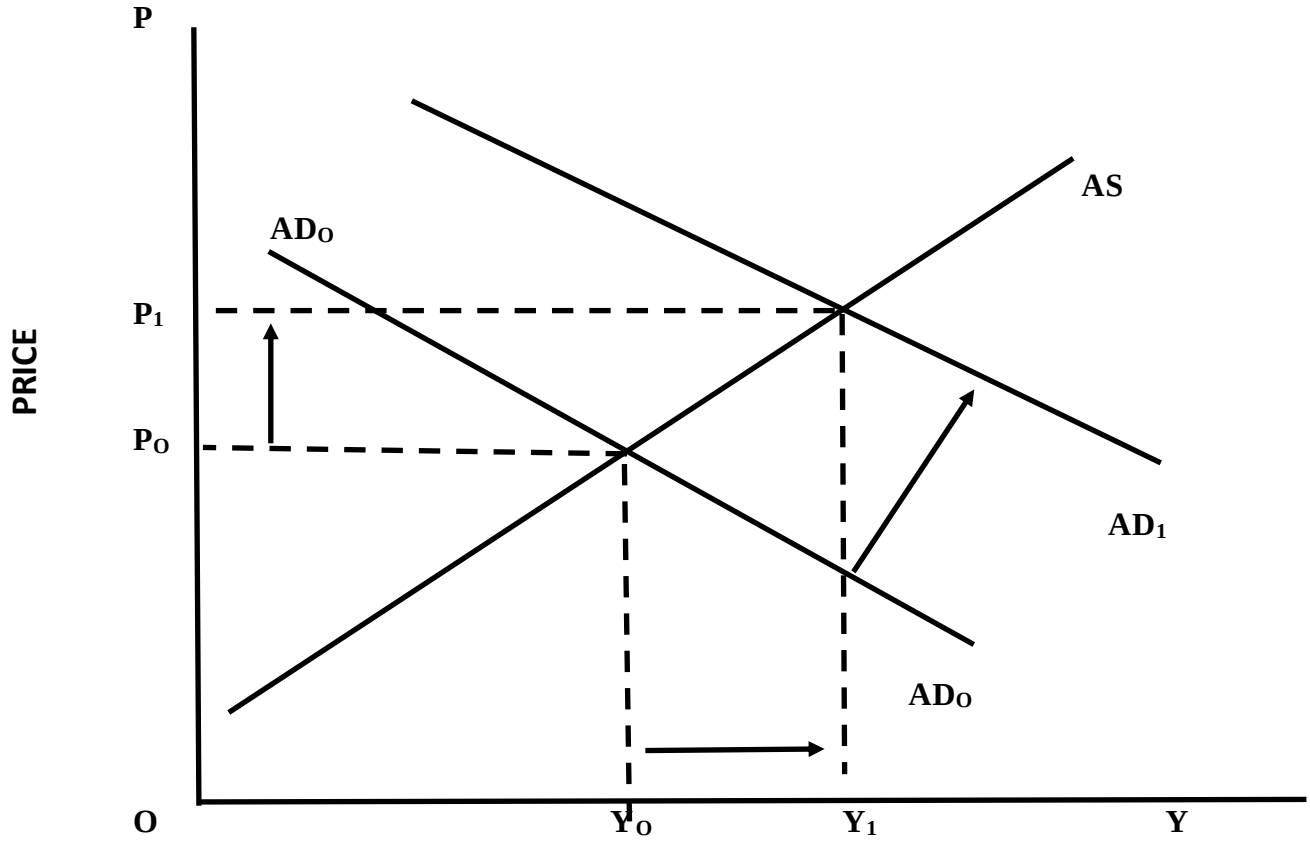
CONSUMER PRICE INDEX	PRODUCER PRICE INDEX
Pertains to cost of living	Pertains to the cost of production
Basket consist of consumer goods and services	Basket consists of goods only (no services)
Capital and intermediate goods are excluded	Capital and intermediate goods are included.

QUESTION 2 **(12)**

2(a) **Use examples to explain the difference between contractionary fiscal policy and expansionary fiscal** **(4)**

The Government controls the Fiscal Policy. The main instruments of Fiscal Policy are Government spending and taxes. If the Government wishes to implement a contractionary policy it can decrease government spending and/or increase taxes. If the government wished to implement an expansionary policy it can increase government spending and/or decrease taxes.

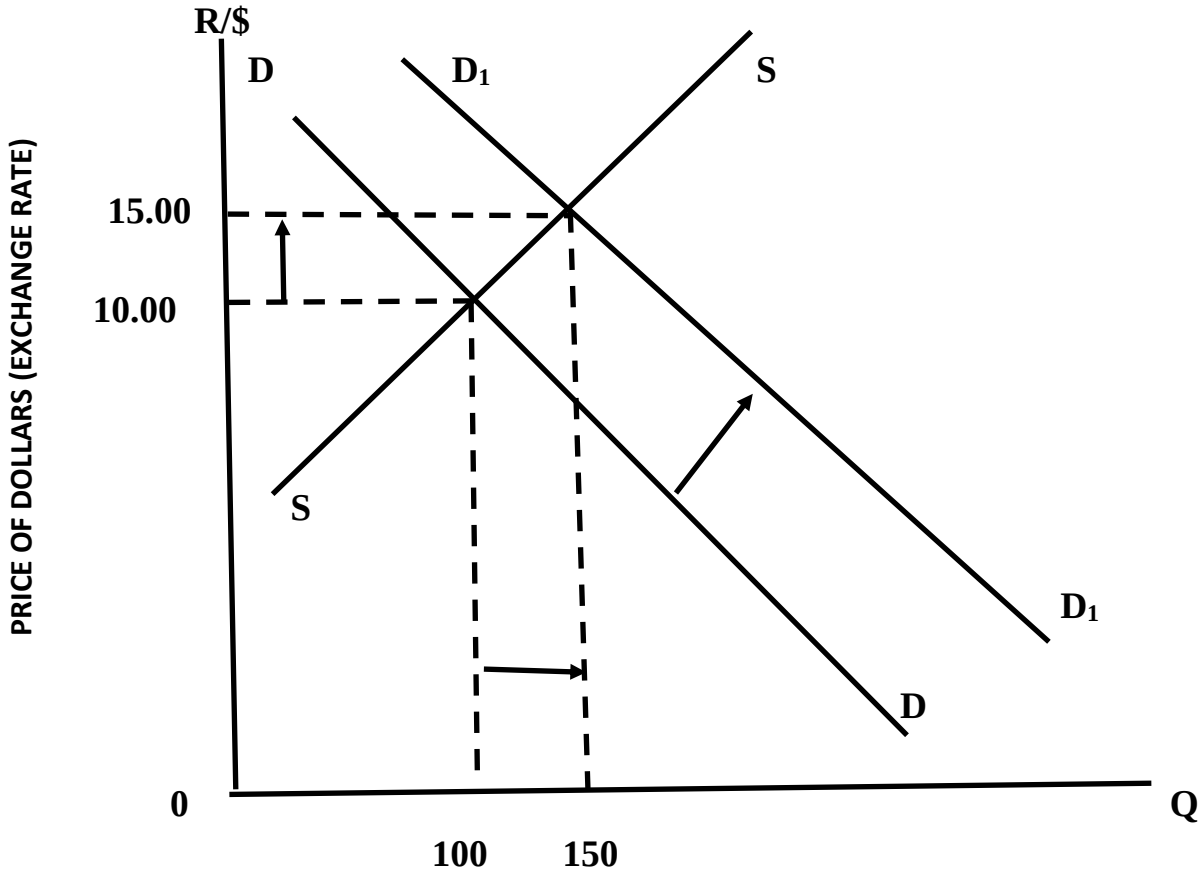
2(b) **Consider the following statement and answer the questions that follow**
"In 2007, the US economy entered into the worst recession since the Great Depression. Real GDP declined by 5.1% and the unemployement rate rose from 4.4% to 10.1%
Use the AD-AS framework to explain how monetary policy can be used to address the problem of declining output and rising unemployment. **(4)**



If the South African Reserve Bank decreases the interest rate this will impact on the demand for investment spending which will increase due to

the lower interest rate. The resukt is that the aggregate demand curve will shift to the right from AD_0 to AD_1. Total production and Income will incrrease but at the cost of higher prices or higher inflation.

2(c) Illustrate and explain by using a diagram, what will happen to the exchange rate between the rand and the US dollar if South African tourists to the United States increase (4)



QUANTITY OF DOLLARS PER DAY (BILLIONS)

If the amount of South African tourists wanting to visit the USA increases there will be more demand for dollars. The demand curve for dollars will shift to the right from DD to DD_1. The equilibrium quantity will increase from 100 to 150 billion. The price for one dollar now increases from R10.00 to R15.00 which means that the rand has depreciated against the dollar.

QUESTION 3 **(13)**

3(a) Explain why the simple Keynesian multiplier tends to be bigger than the multiplier derived after the introduction of the government sector (2)

This is due to the multiplier effect. When the government increases its spending this is an injection into the economy. The multipler then takes over an as each round of spending occurs more money is generated into the economy but at the rate of the multiplier money which is derived from the MPC.

3(b) Suppose you are given the following information about the South African economy. Use the information to answer questions (i), (ii) and (iii)

INCOME (BILLIONS IN RAND)	CONSUMPTION EXPENDITURE (BILLIONS IN RAND)	SAVING (BILLIONS IN RAND)
0	260	-260
1100	1140	-40
1200	1220	-20
1300	1300	….. 0
1400	1380	20
1500	1460	….. 40

(i) Calculate the marginal propensity to consumer and the marginal propensity to save (4)

(i) The marginal propensity to consume (2)

$$MPC = \frac{\Delta C}{\Delta Y}$$

$$\frac{1460 - 1380}{1500 - 1400}$$

$$\frac{80}{100}$$

$$MPC = 0.80$$

(ii) The marginal propensity to save (2)

$$MPS = 0.20$$

(ii) Calculate the multiplier (2)

$$\alpha = \frac{1}{1 - c}$$

$$\alpha = \frac{1}{1 - 0.80}$$

$$\alpha = \frac{1}{0.20}$$

$$\alpha = 5$$

(iii) Indicate on the table, the value of saving at income levels 1300 and 2500 (2)

0 and 40

3(c) Explain how a 1% decrease in the repo rate could affect the general price level in the economy (3)

If the repo rate decreases by 1% then the AD curve will shift to the right which will cause an increase in the price level.

QUESTION 4 **(13)**

4(a) Write a paragraph in which you exlain two supply – side policies and two demand-side policies that can be used to reduce unemployment (4)

Demand side steps:

- Additional employment opportunities can be created by raising the aggregate demand for goods and services, and increasing the labour intensity of production.
- Increased government spending (expansionary fiscal policy)
- Stimulate consumption and investment spending by lowering taxes or interest rates.
- Raise the demand for domestically produced goods and services by increasing the demand for exports
- Promoting labour intensive industries and labour-intensive production methods.
- Special employment programmes such as building dams, sports stadiums, etc.
- Promoting small businesses and the informal sector.
- Offering tax incentives or subsidies to firms to stimulate employment.

Supply side steps:

- Steps should be taken to limit population growth (long-term strategy).
- Stricter immigration control (controversial)
- Reduce oversupply of unskilled and semi-skilled labour by improving the quality of labour through education and training.

4(b) Name any two policies that can be used to combat each of the following (4)

(i) Cost push inflation: Incomes policy by reducing the costs of production. Increase in productivity (both impact on aggregate spending curve)

(ii) **Demand pull inflation:** Monetary policy: Decrease interest rate. Fiscal policy: Increase government spending

4(c) Define the following concepts **(5)**

(i) Economic growth: Economic growth is defined as the **year on year increase in total production or income**. Alternatively, it is defined as "the annual rate of increase in real gross domestic product (real GDP)."

(ii) **Unrecorded activity: The unrecorded transactions** are the next entry on

the BOP. Since the double entry system is used to record transactions on the BOP, the net sum of all credit and debit entries, should equal the change in the countries net gold and other foreign reserves. In reality this does not happen. All mistakes and omissions are recorded in the "unrecorded transactions".

(iii) **Business cycle:** This is the pattern of upswings (expansion) and downswings (contraction) that all modern economies are faced with over a number of years. One complete business cycle has four phases: a trough, an upswing or expansion (a "boom"), a peak and a downswing or contraction ("recession").

(iv) **Capital Deepening:** *Capital deepening* means that the growth in capital is greater than the growth in the labour force.

(v) **Domestic demand:** Economic growth can be achieved by a rise in domestic spending (C + I + G), a rise in export demand (X) and a reduction in imports (Z). Make sure you are able to discuss each of the components of domestic demand.

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QUESTIONS	ANSWERS
1	4
2	3
3	1
4	3
5	3
6	4
7	1
8	1
9	4
10	1
11	3
12	2
13	4
14	4
15	3
16	4
17	2
18	4
19	2
20	2
21	3
22	1
23	4
24	3

25	**2**
26	**3**
27	**1**
28	**3**
29	**2**
30	**3**

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QUESTION 1 (11)

(i) List two important injections and two important leakages from the circular flow of income and spending (2)

Injections: Consumptions spending, Investment spending, Government spending, Exports

Leakages: Savings, taxes and imports

(ii) **Briefly explain the relationship between the demand for money and the interest rate. (3)**

(iii) Briefly describe an expansionary fiscal policy (2)

The Government is in control of the fiscal policy. The two main instruments used in the fiscal policy are Government spending and taxes.

If the Government want to employ an expansionary policy it will increase its spending and/or decrease its taxes.

(iv) Identify and briefly describe one macroeconomic objective (2)

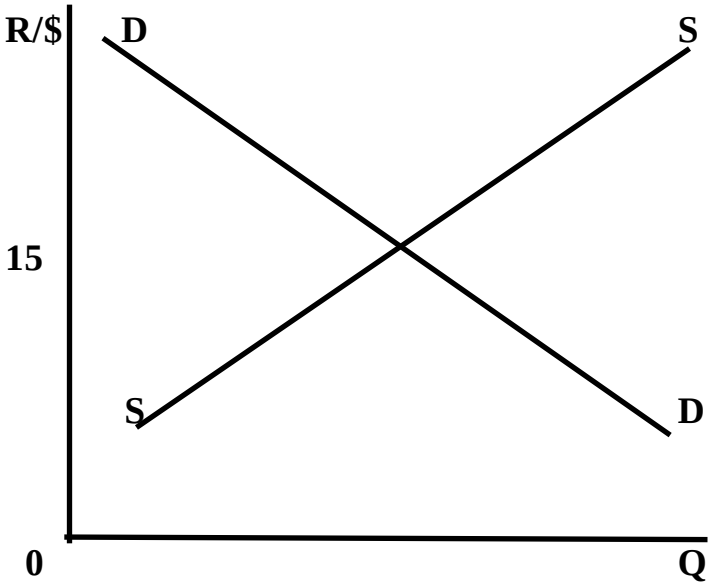
- Economic growth
- Full employment
- Price stability
- Balance of payments stability (for external stability)
- Equitable distribution of income.

(v) Briefly explain why the link between the interest rate and investment spending is important in the monetary transmission mechanism (2)

There is an inverse relationship between interest rates and investment spending. The higher the interest rate the lower the demand for investment spending. The lower the interest rate the higher the demand for investment spending.

QUESTION 2 (8)

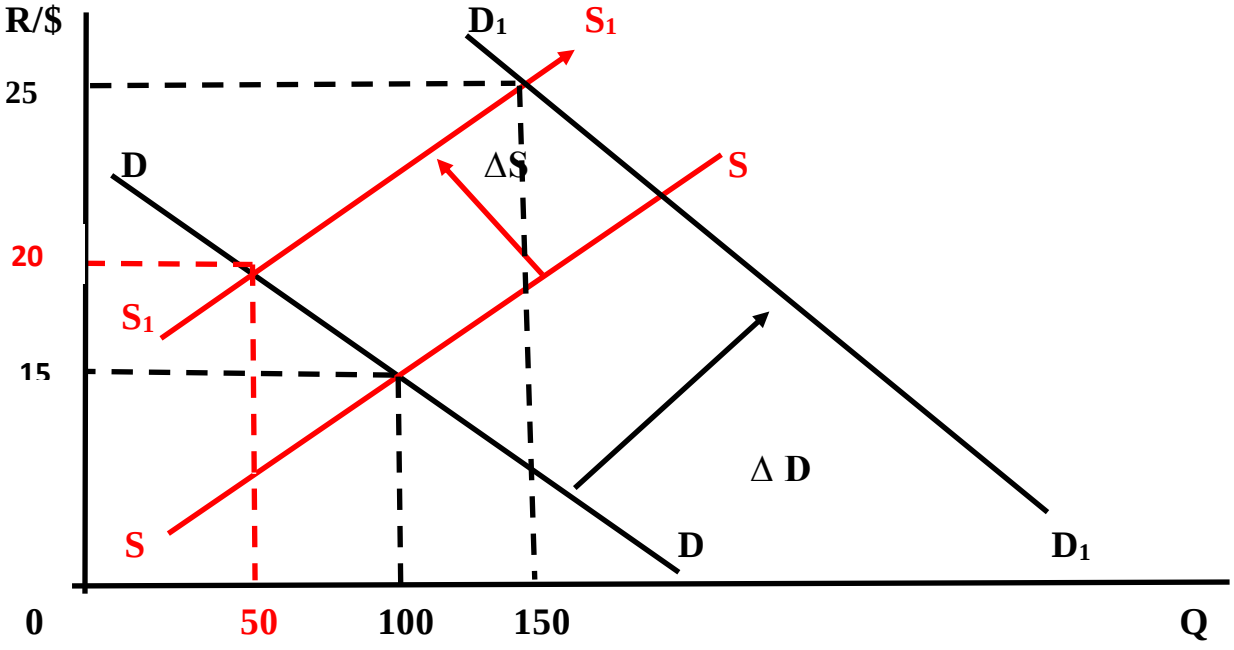
Question 2 is based on the following diagram of the rand/dollar exchange market



Use the above diagram to illustrate and explain the impact of the following events on the rand/dollar exchange market

(a) An economic recession occurs in the economies of major trading partners of South Africa.

(b) Foreign investors sell South African financial assets (8)



QUANTITY OF DOLLARS (000S)

This is the first time that I have seen UNISA ask for two questions using the same diagram. I will be working on the original graph for both questions.

(a) The first question relates to the supply of dollars. Because there is an economic recession in South Africa's major trading departments it means that SA exports will decrease and this will impact on the supply for dollars. Hence, the supply of dollar will decrease in South Africa. The supply curve shifts to the left from SS to S_1S_1 and the equilibrium quantity decreases from 100 to 50. The result is that the rand/dollar exchange rate increase to R20 for $1 from R15 for $1. This means that the rand has depreciated against the dollar.

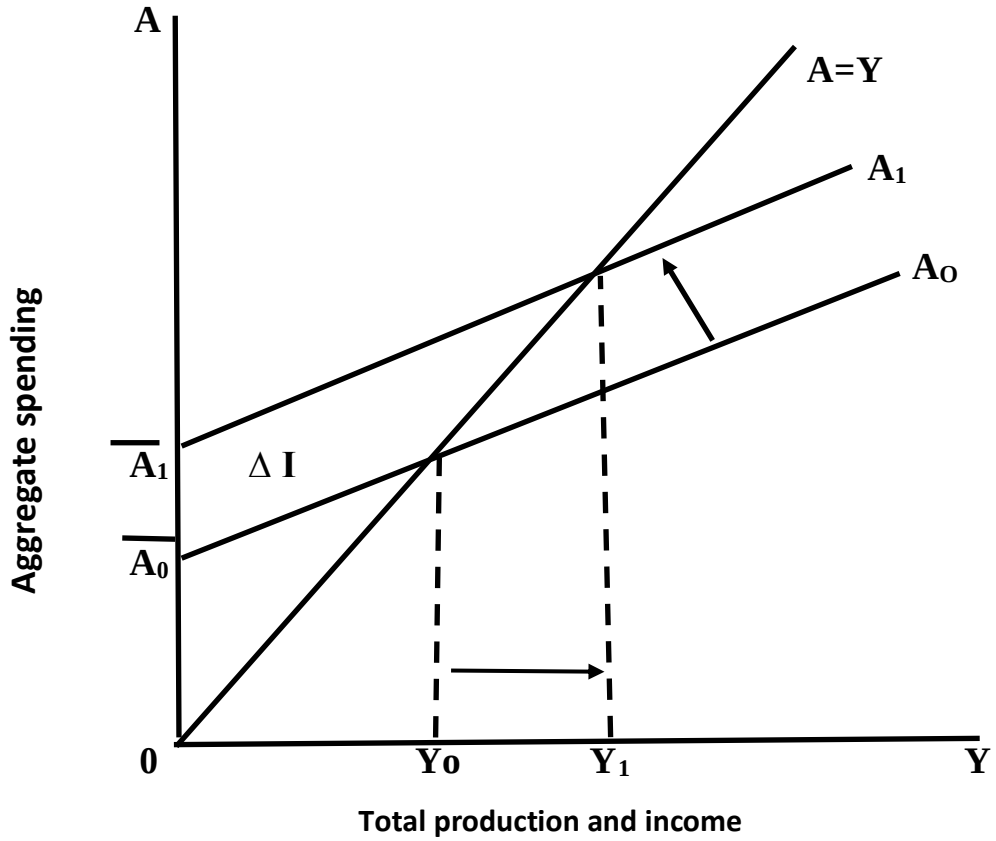
(b) The second question relates to the demand for dollars. When foreign investors sell their South African assets they will require dollars. The demand curve for dollars will therefore increase and shift to the right. The result is the demand curve for dollars will increase and the demand curve for dollars will shift to the right from DD to D_1D_1. The result is that 1$ now costs R25 and opposed to the original price of R20 for 1$. This means that the rand has depreciated against the dollar

QUESTION 3 **(12)**

Question 3(i) is based on the simple Keynesian model with a government sector.

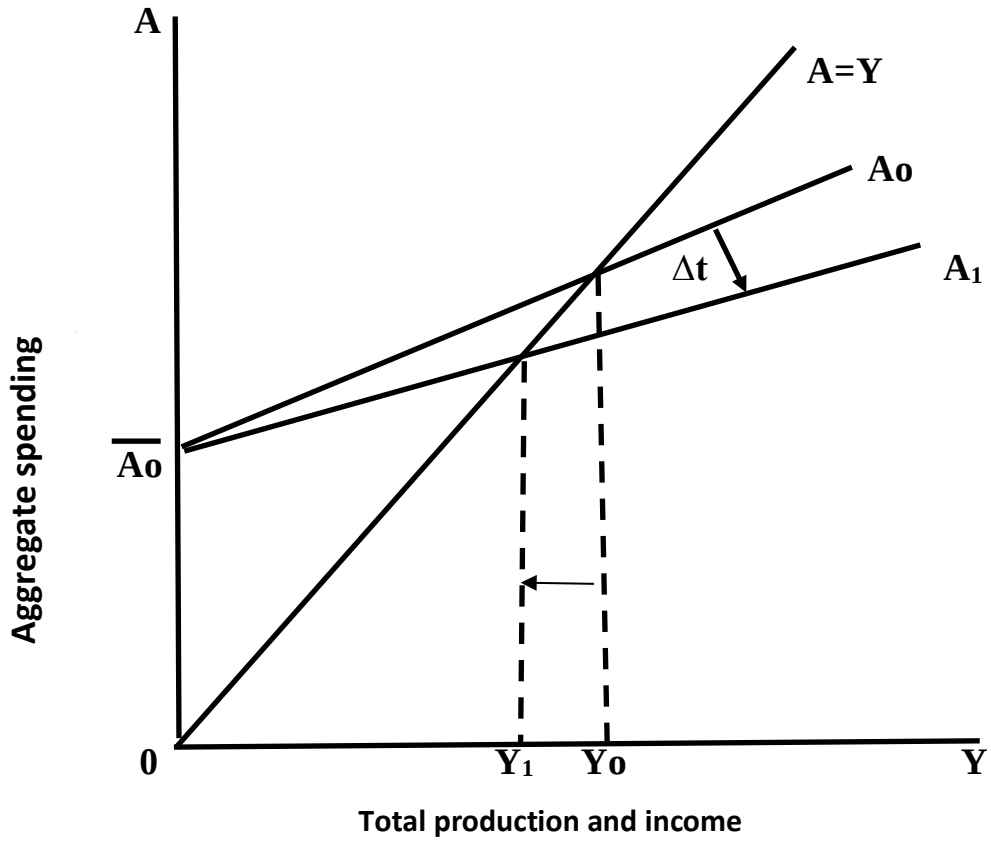
(i) Use diagrams to illustrate the impact of

(a) An increase in investment spending (5)



(a) With the increase in investment spending the aggregate spending curve moves upwards from A_o to A_1. The level of income and output has increase

from Y_o to Y_1. The change in total income and output is greater than the change in investment spending due to the multiplier effect.



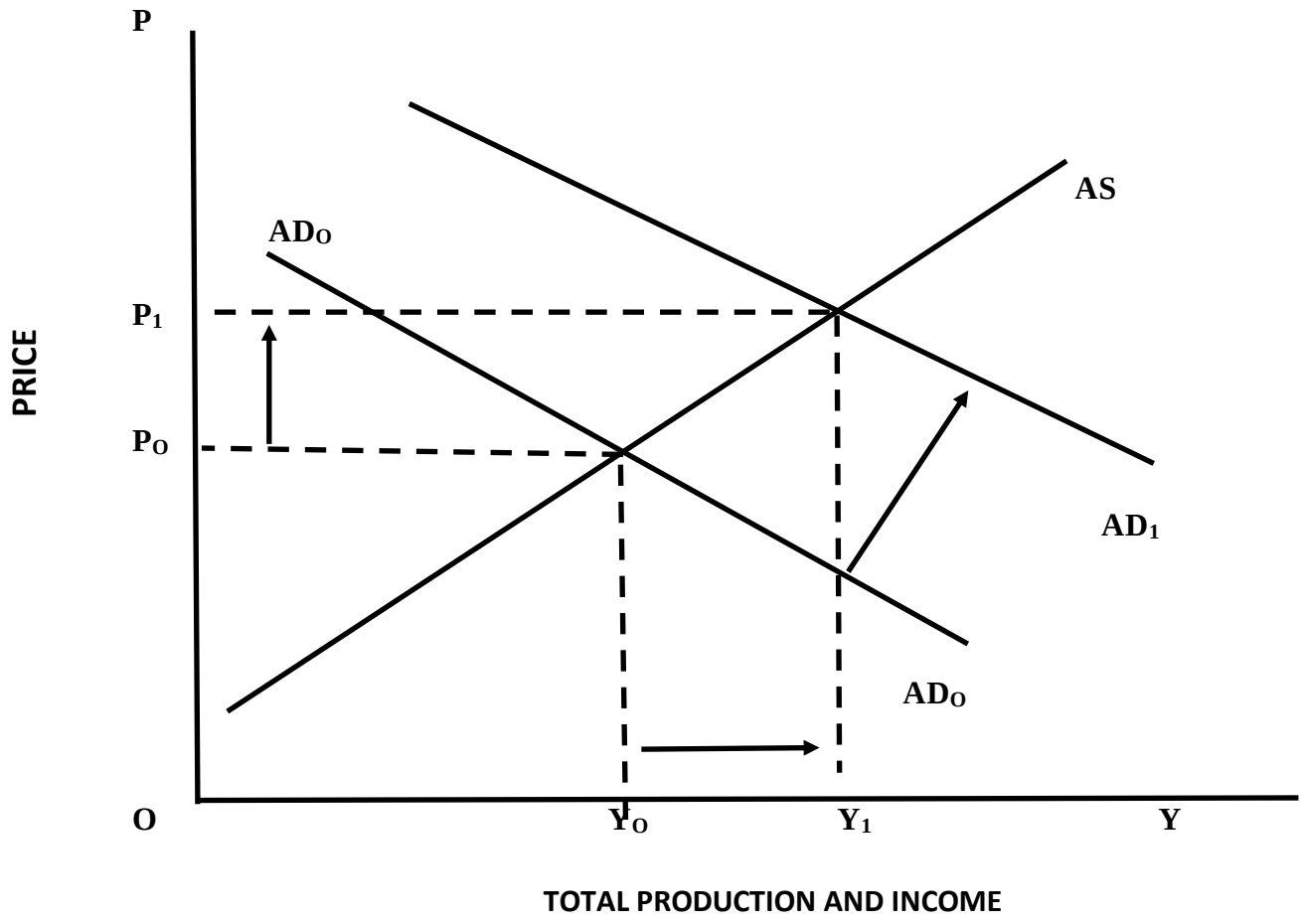
(ɒ) With an increase in taxes the aggregate spending curve swivels downwards from A_o to A_1. Total production and income decreases from Y_o to Y_1. The increase in tax does not affect the autonomous aggregate spending only the slope of the aggregate spending curve.

(ii) Identify two factors that can cause an increase in the value of the multiplier in a simple Keynesian model with a government and foreign sector (2)

A decrease in the tax rate, a decrease in the Marginal propensity to import (MPI) and an increase in the marginal propensity to consume (MPC) or a decrease in the marginal propensity to save (MPS).

QUESTION 4

Question 4(i) is based on the following AD-AS model



In this model certain events took place that led to an increase in the price level and an increase in the level of output and income.

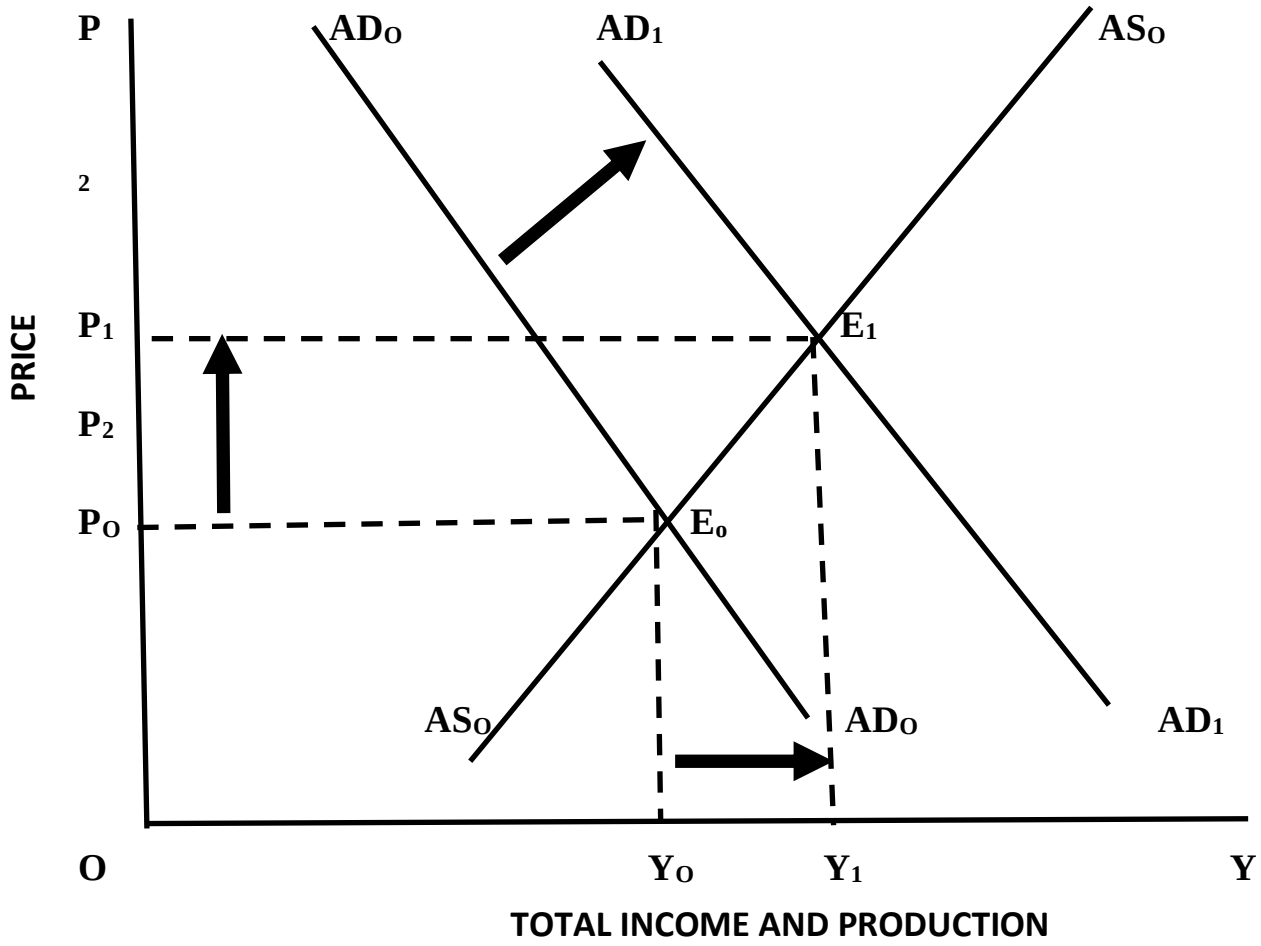
(i) Use the diagram to identify what possible events could have caused this end result and describe how these events led to these results. (4)

The following are events that could have taken place which led to a shift to the right of the aggregate demand (AD) curve to the right. An increase in any type of spending (C,I,and G,) It could be as a result of either fiscal policy (taxes have been decreased) or Monetary policy (interest rates have decreased).

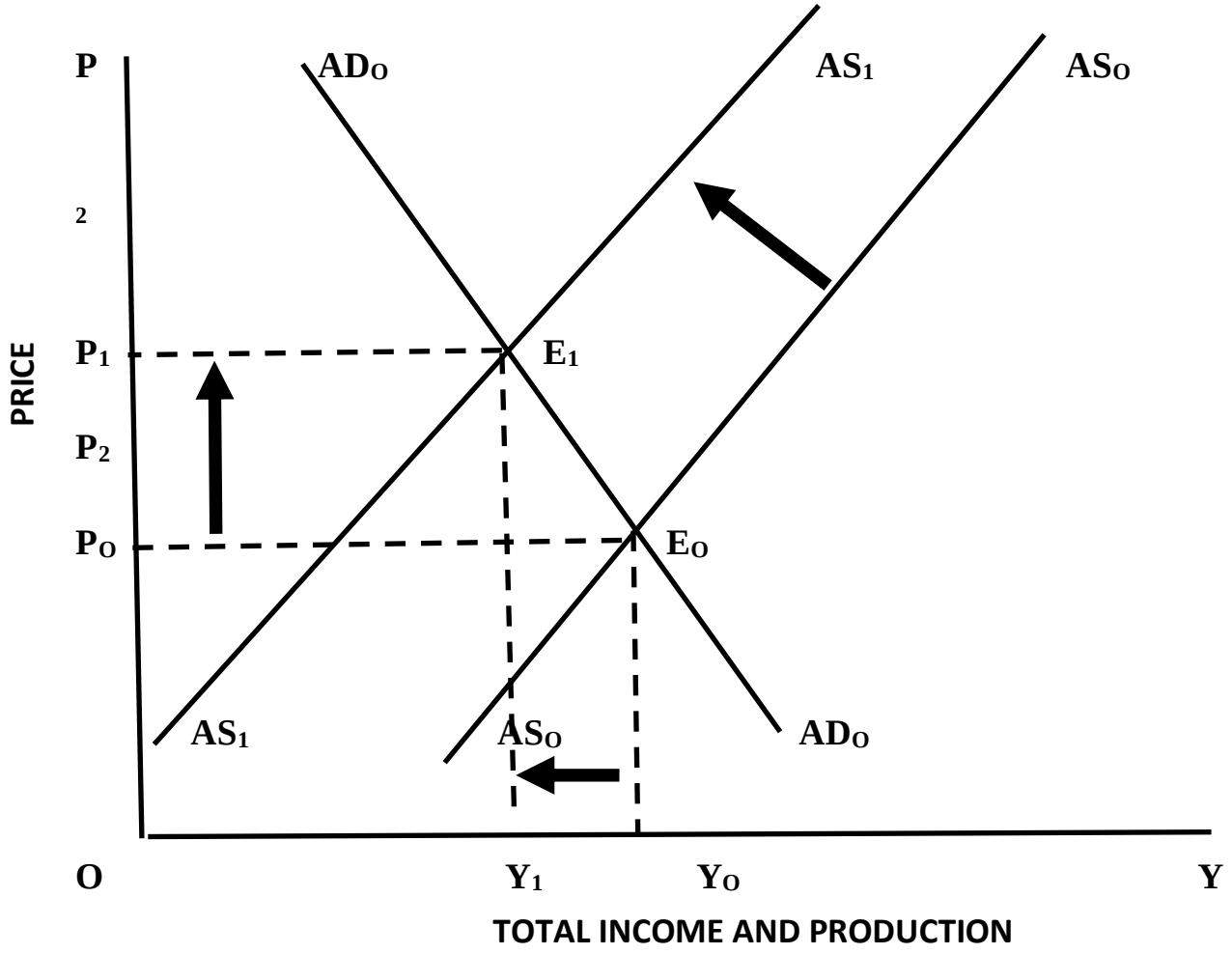
If we assume that there was a decrease in the interest rate (an expansionary monetary policy) which led to an increase in Investment spending, this will result in a shift of the AD to the right from AD_o to AD_1. The impact is an increase in the level of income and output from Yo to Y_1, which reduces unemployment. However the impact on the price is an increase from Po to P_1. This means that the monetary policy has succeeded in decreasing unemployment but at the expense of inflation. (Higher prices).

(ii) Use the following diagrams to illustrate the difference between demand – pull and cost-push inflation (4)

DEMAND – PULL INFLATION



COST PUSH INFLATION



QUESTION 5

(i) Structural unemployment is a serious issue that needs to be dealt with in South Africa. Describe structural unemployment and possible solutions for structural unemployment (5)

Structural unemployment occurs when jobs are made redundant and the people who used to occupy those positions have found that their skills are also redundant and no longer required in the labour market. Examples included miners (due to mines closing down) and bank tellers (who were replaced by ATM machines), changes in consumer tastes.

Solutions: Develop training programmes so that these individuals can learn new skills which are required in the labour market. Encourage small business and entrepreneurship.

(ii) During the past few tears South Africa has experienced low economic growth rates. One way of explaining economic growth is to look at the demand factors and the supply factor that determine economic growth.

Identify two demand factors and two supply factors of economic growth and explain the possible impact these factors would have on economic growth in South Africa. (6)

Demand factors:

- **Domestic demand:** Increase demand for goods and services in the domestic market. This will increase employment and contribute to economic growth.
- **Exports:** An increase in export raises the growth rate and relieves the balance of payments constraint
- **Import substitution.** This is also linked to the balance of payments. If south Africa could manufacturer those goods that were previously imported this would create employment and consequently economic growth.

Supply factors:

- **Natural resources:** New techniques or price increases may make it profitable to exploit certain mineral deposits. Increasing this output will increase economic growth
- **Labour:** If South Africa could train up his labour force to a **quality** labour force with skills that can utilised in creating new innovations and technologies and well as maintain these new discoveries then this will also contribute to economic growth.
- **Entrepreneurship:** This is the fastest way of growing the economy. Entrepreneurs are the driving force behind economic growth.

SECTION B MAY/JUNE 2017

QUESTION	ANSWER	
B1	5	
B2	2	
B3	5	
B4	4	
B5	1	
B6	4	
B7	3	
B8	2	
B9	3	
B10	2	
B11	2	
B12	4	
B13	1	
B14	1	
B15	2	
B16	2	
B17	1	
B18	1	
B19	3	
B20	2	
B21	4	
B22	3	
B23	4	
B24	2	
B25	1	
B26	4	
B27	1	
B28	4	
B29	4	
B30	4	

ECS 1601

OCTOBER/NOVEMBER 2016 SOLUTIONS.

SECTION A COMPULSORY ESSAY QUESTIONS

QUESTION 1:

1(a) BRIEFLY EXPLAIN DEMAND MANAGEMENT POLICIES AND HOW THEY CAN BE USED IN THE ECONOMY (3)

There are two policies that can be used to manage the demand for goods and services

(i) **The Fiscal policy (Government):** The two main instruments that the government can use to manage the demand for goods and services are government spending the taxes

- **Expansionary/Stimulatory policy:** Increase Government spending and/or decrease taxes
- **Restrictive/contractionary policy:** Decrease government spending and/or increase taxes.

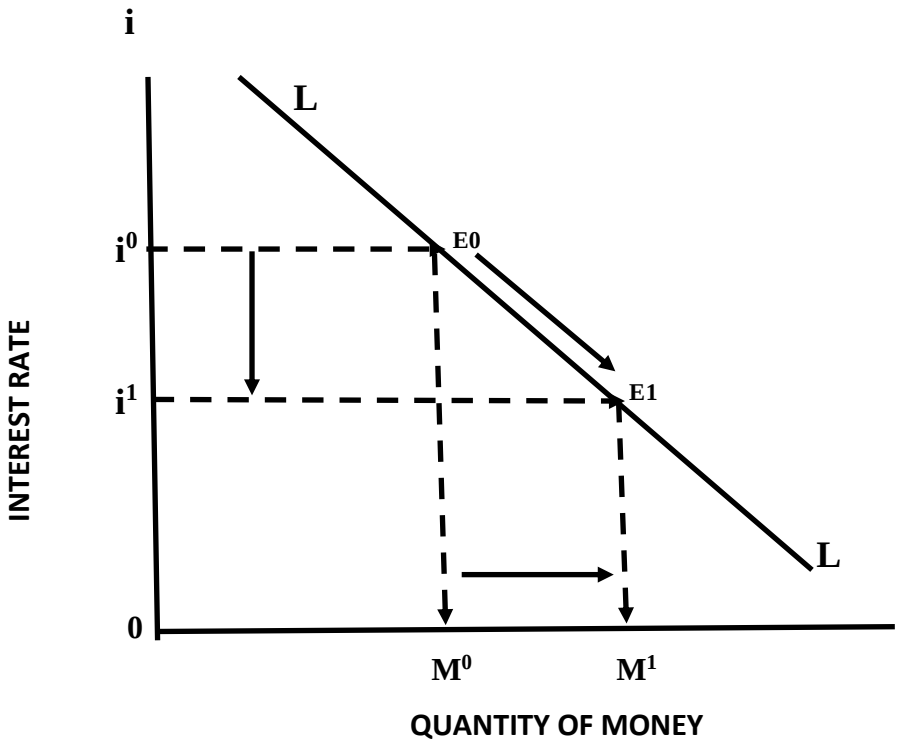
(ii) **The monetary policy (SARB):** The main instrument used by the Reserve bank is the interest rate.

- **Expansionary/Stimulatory policy:** Decrease the interest rate.
- **Restrictive/contractionary policy:** Increase the interest rate.

1(b) DISTINGUISH BETWEEN A FLOW VARIABLE AND A STOCK VARIABLE. GIVE ONE EXAMPLE OF EACH (4)

- **Flow variable:** This type of variable is measured over a period. E.g On 25th April 2014 the inflow into Gariep dam was measured at 88cubic meters per second.
- **Stock variable:** This particular variable can only be measured exactly at a particular point in time. At 0.00 on 25th April 2014 the level at the Gariep dam was at 95.8%

1(c) USE A DIAGRAM TO EXPLAIN HOW A DECREASE IN THE INTEREST RATE WILL AFFECT THE QUANTITY OF MONEY. (4)



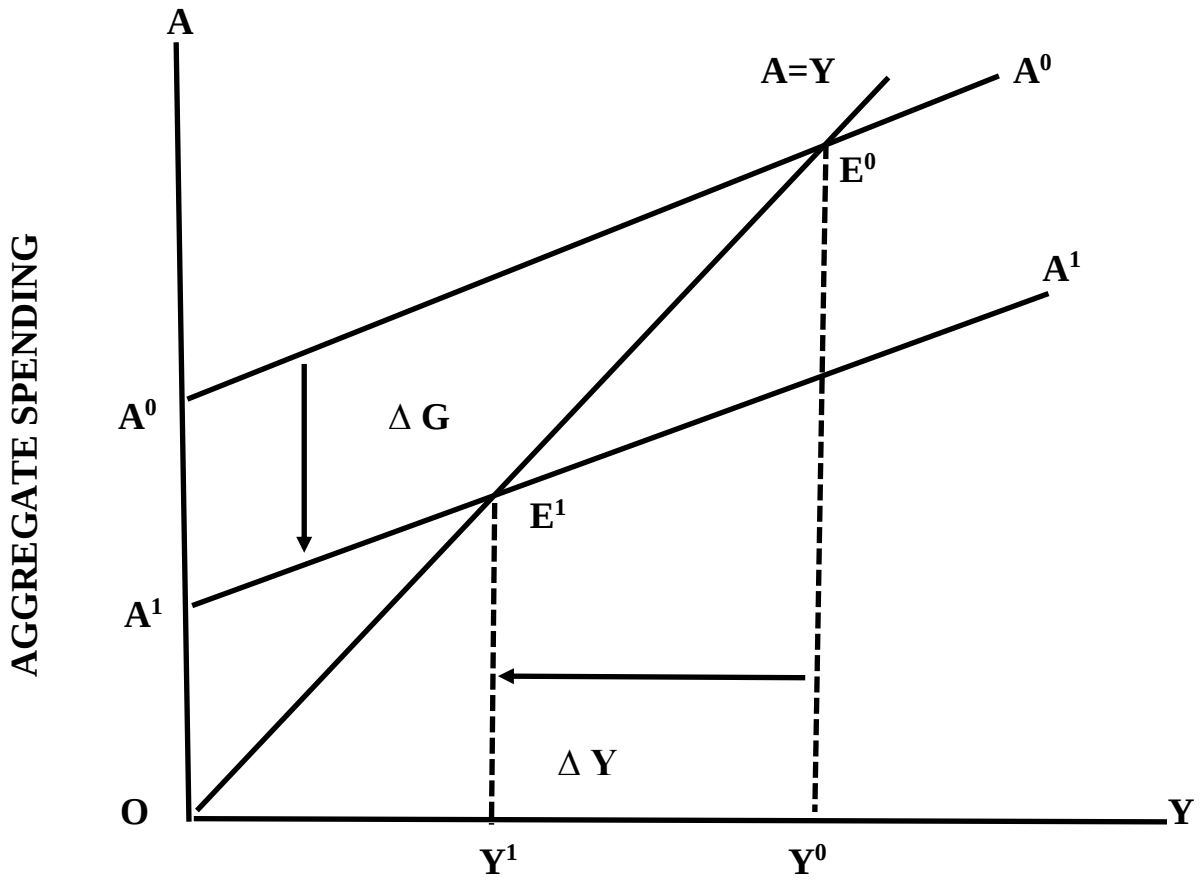
With an decrease in the interest rate from i^0 to i^i the quantity of money demanded will increase from M^0 to M^1 and the equilibrium has decreased from E^0 to E^1

1(d) LIST THREE WAYS IN WHICH GOVERNMENT SPENDING CAN BE FINANCED. (3)

(i) Income from property
(ii) Taxes
(iii) Borrowing

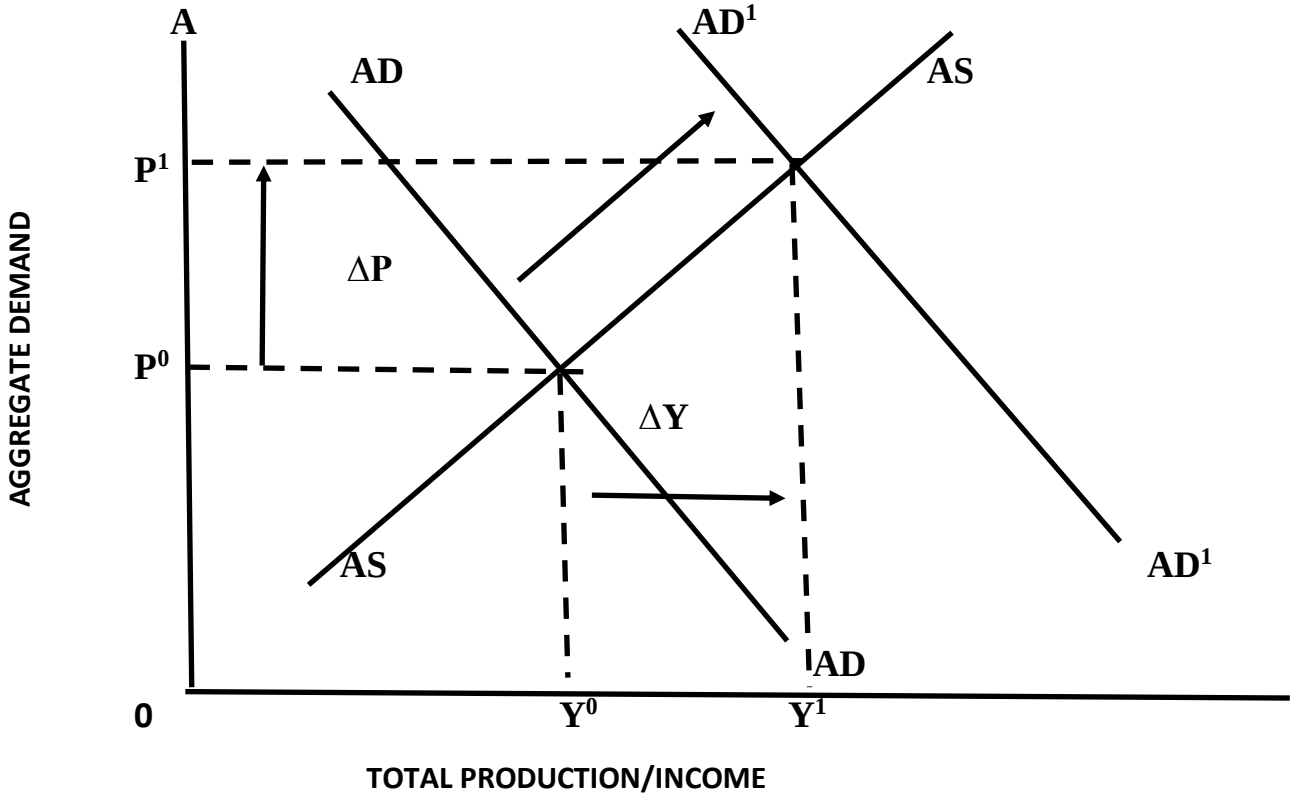
QUESTION 2

2(a) USE A DIAGRAM TO EXPLAIN HOW A DECREASE IN GOVERNMENT SPENDING WILL AFFECT THE LEVEL OF INCOME IN THE KEYNESIAN MODEL. (5)



With the decrease in Government spending the aggregate spending curve shifts downwards from A^0 to A^1. This impacts on total income which decreases from Y^0 to Y^1. The equilibrium level of income decreases from E^0 to E^1

2 (c) SOUTH AFRICA EXPERIENCED A SEVERE DECLINE IN REAL GROSS DOMESTIC PRODUCTION DURING THE LAST QUARTER OF 2008 AND THE TWO QUARTERS OF THE FIRST HALF OF 2009. USE THE ADAS MODEL TO ILLUSTRATE AND EXPLAIN THE POLICIES THAT COULD BE USED TO RESOLVE THIS SITUATION. (5)



With the severe decline in real gross domestic production during lat quarter of 2008 and the two quarters of the first half of 2009 the following polies can be implemented

(i) **Fiscal policy:** Increase Government spending and/or decease Taxes

(ii) Monetary policy: Decrease interest rates.

THE QUESTION ONLY ASKS FOR ILLUSTRATION AND THE POLICIES THAT CAN BE USED TO COMBAT THE DECLINE IN GDP NOT AN EXPLANATION OF THE GRAPH.

QUESTION 3:

SUPPOSE AN ECONOMY IS EXPERIENCING COST-PUSH INFLATION THAT HAS RESULTED IN AN INCREASE IN THE GENERAL PRICE LEVEL, ACCOMPANIED BY A DECREASE IN PRODUCTION.

3 (a) EXPLAIN ANY THREE MEASURES THAT CAN BE USED TO DO AWAY WITH COST-PUSH INFLATION (3)

It is important to note that one cannot use demand management to combat or deal with cost-push inflation. This can only be done from the supply side. This can be done by:

(i) **Decrease wage and salaries**: This is very difficult to do since it will bring about both economic and psychological consequences which will lead to loss of jobs and frustration and anger from the population. (Shift of the AS curve to the right)

(ii) **Decrease profits**: Again difficult to do since capitalism is driven by self-interest and profit and most companies will be very reluctant to reduce their profits to the detriment of their shareholders. (Shift of AS curve to the right)

(iii) Increase productivity: This is probably the best solution because with an increase in productivity inflation will decrease and GDP will increase and hence employment will also increase. (Shift of the AS curve to the right)

3(b) EXPLAIN WHY POLICY MAKERS REGARD INFLATION AS A PROBLEM. REFER TO THE EFFECTS OF INFLATION IN YOUR EXPLANATION (5)

There is a relationship between high inflation and unemployment (the higher the inflation the lower the unemployment and the lower the inflation rate the higher he unemployment rate). Higher inflation leads to higher prices which consumers cannot afford to pay for so unemployment results. If the authorities want to reduce unemployment by increasing spending the result is an increase in inflation. There are three sets of effects on inflation:

(i) **Distribution effects:** Inflation affects the distribution of income and wealth among the various participants in the economy.

- Inflation benefits debtors (borrowers) at the expense of creditors (lenders). If Joe lends R1000.00 to Jack and the inflation rate is 10% then Jack effectively only has to pay R900 back to Joe (R1000 – 100 =R900 (real income)). The same problem applies to interest rate. If the nominal interest rate is lower than inflation then the interest rate will be negative.
- Redistribute income and wealth from the elderly (lenders) to the young (borrowers).
- Since the Government is always a borrower so there is redistribution of income and wealth form the private sector to the government.

(ii) Economic effects: if decision makes in the private sector anticipate inflation they will look for other ways to divert their efforts.

- They will indulge in **speculative practices** such as investing in classic cars, shares property etc. and not in new innovative production methods or products and services.
- **Discourage savings**
- **Balance of payments problems**

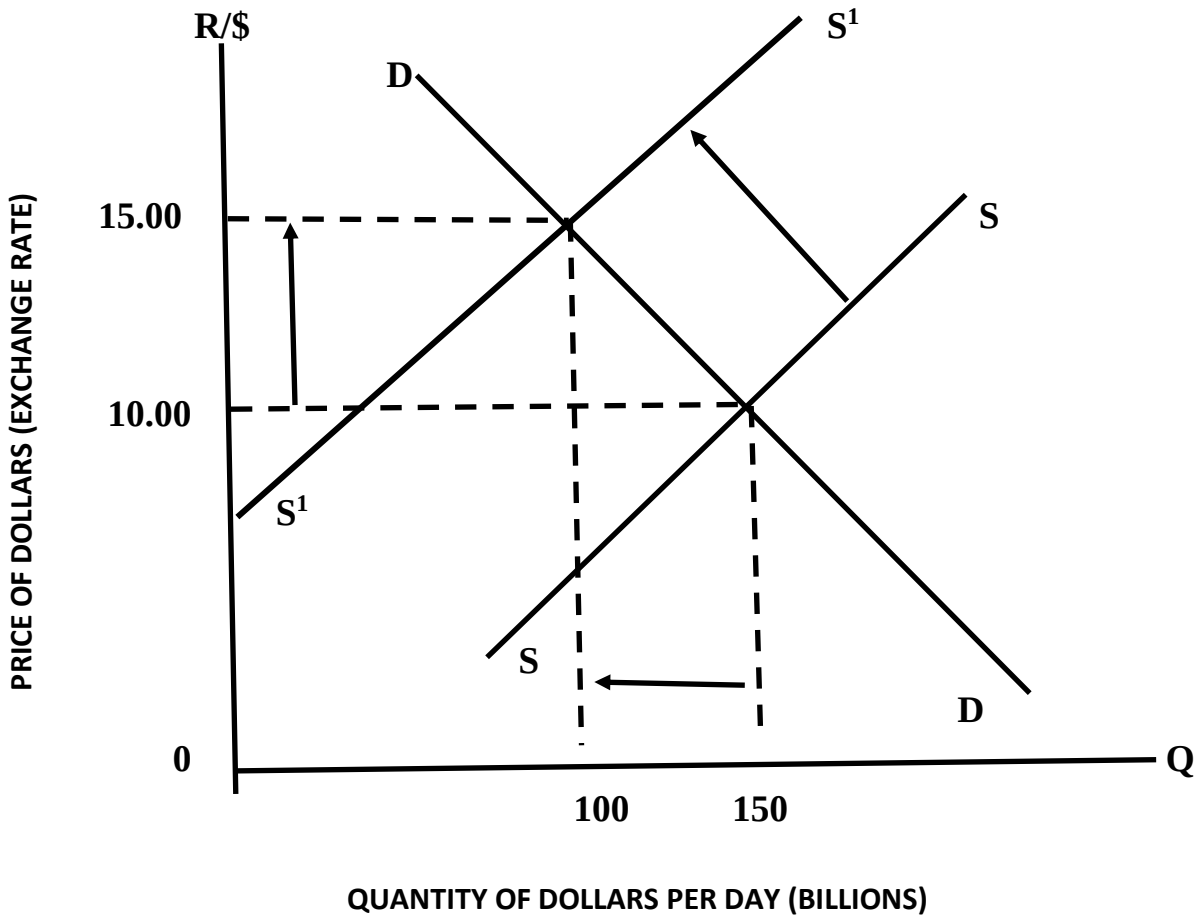
(iii) **Social and political effects:** Inflation forces prices up and this effect large segments of the population, especially the poor, because they now have to pay increased taxi fares, rents, services, etc. Inflation I public enemy no 1.

3 (c) BRIEFLY EXPLAIN THE CONFLICT APPROACH TO INFLATION. (5)

Mohr et al 2015 states that inflation I a symptom of a fundamental disharmony in society which results in a continuous imbalance between the rate of growth of the total effective claims on this income. The different economic and social groups together claim more income than is produced. As the rival groups (trade unions, employer organisations, large firms, business organisations, professional associations etc.) each try to claim more than their share in "the pie" inflation results.

QUESTION 4:

4(a) SUPPOSE THE GOLD PRICE RISES IN SOUTH AFRICA. USING A DIAGRAM, EXPLAIN HOW THIS RISE IN THE GOLD PRICE WILL AFFECT THE RATE BETWEEN THE SOUTH AFRICAN RAND AND THE US DOLLAR, CETERIS PARIBUS. (4)



With the increase in the price of gold in South Africa there will be less exports since gold is one of SA's main exports. This means hat dollars will come into South Africa with this drop in exports. This results in the supply curve for dollars shifting to the left from SS to S^1S^1. The quantity of dollars will decrease from 150 billion to 100 billion per day. The rand has depreciated from R10 per dollar to R15.00 per dollar.

4(b) MENTION AND EXPLAIN TWO FACTORS THAT INFLUENCE THE EFFECTIVENESS OF THE MONETARY TRANSMISSION MECHANISM (4)

The key element of the transmission mechanism is in the relationship between the interest rate (*i*) and investment spending (*I*) which is an important component of both aggregate spending and aggregate demand. There is an inverse relationship between interest rates and investment spending. The higher the interest rate the less demand for investment spending. The lower the interest rate the higher the demand for investment spending. Unless investment spending has an inelastic demand to interest rates. $\Delta i \Rightarrow \Delta I \Rightarrow \Delta A \Rightarrow \Delta Y$

A change in the interest rate leads to a change in investment spending, a change in aggregate spending and a change in chnge in total production or income. This applies to the Keynesian model which assumes that prices and wages are fixed.
We drop this assumption when we move to the AD-AS model, we get the following formula

$$\Delta i \Rightarrow \Delta I \Rightarrow \Delta A \Rightarrow \Delta AD \begin{cases} \nearrow \Delta Y \\ \searrow \Delta P \end{cases}$$

A change in the interest rate leads to a change in investment spending, a change in aggregate spending and a change in aggregate demand. The change in aggregate demand results in a change in total production or income and a change in the price.

SECTION B

QUESTION	ANSWER	
B1	1	
B2	2	
B3	3	
B4	3	
B5	2	
B6	2	
B7	3	
B8	1	
B9	2	
B10	4	
B11	1	
B12	3	

B13	5	
B14	5	
B15	2	
B16	1	
B17	4	
B18	3	
B19	4	
B20	3	
B21	2	
B22	2	
B23	1	
B24	1	
B25	5	
B26	4	
B27	4	
B28	1	
B29	1	
B30	3	

ECS 1601 EXAM PAPER MAY/JUNE 2016

SECTION A – COMPULSORY ESSAY QUESTIONS
Answer ALL the following questions in the space provided. Section A counts 50 marks in total.

Question 1 (13)

(1a) Define money. (2)

Money is anything that is generally accepted as payment for goods and services or that is accepted in settlement of debt (page 256 text book)

(1b) (1b) Distinguish between the three broad functions of government. (3)

(i) **Allocative function:** This refers to the role of government in correcting market failure and achieving a more efficient allocation of resources

(ii) **The distributive function:** This refers to steps taken by the government to achieve a more equitable or socially acceptable distribution of money ta that generated by market forces

(iii) **The stabilisation function:** This refers to the measures taken by government to promote macroeconomic stability (full employment, price stability and balance of payments stability) (page 286 text book)

(1c) Define the South African balance of payments. (2)

Each country keeps a record of its transactions with the rest of the world. Hs accounting record is called the **balance of payments.** (page 249 text book)

(1d) Differentiate between nominal and real prices. (2)

Nominal prices include inflation and real prices exclude inflation. It would be senseless to just calculate monetary values between different years, allowances have to be made for the fact that prices increase. (page 239 text book)

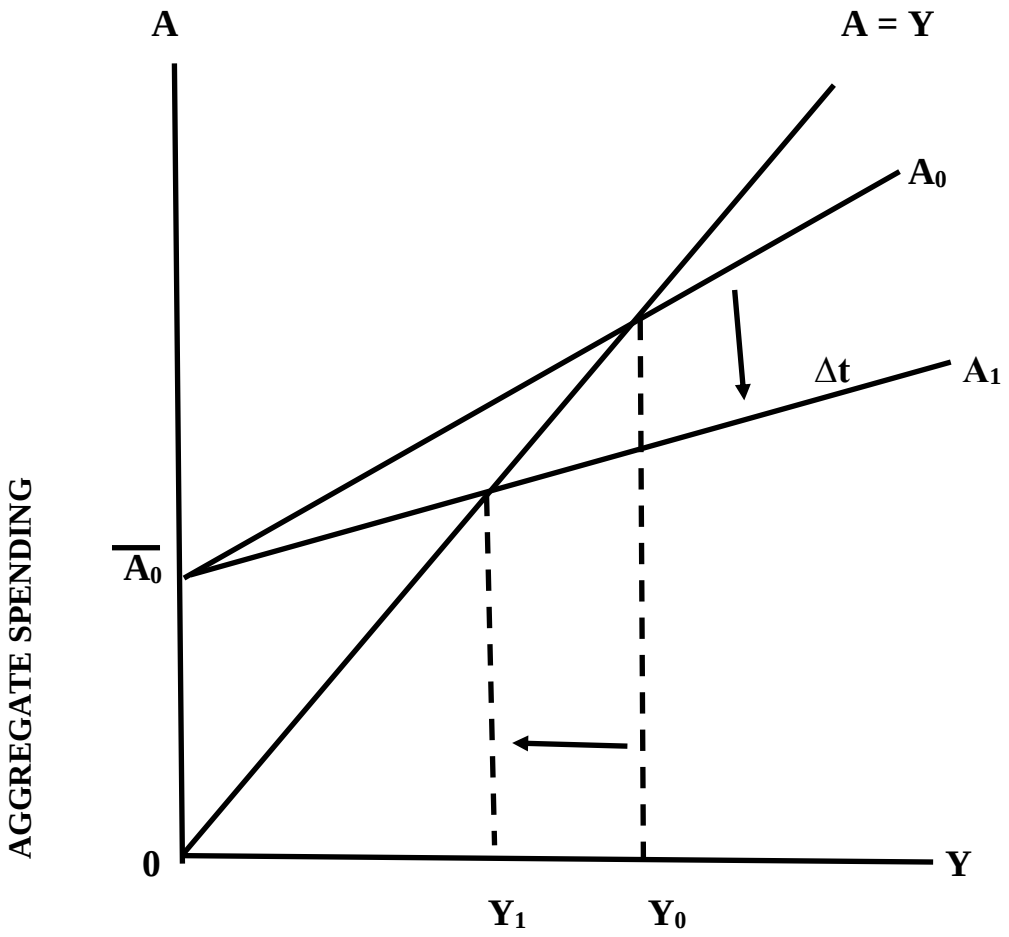
(1e) List four problems associated with GDP as a measure of total production in the economy. (4)

What are the **problems** with using GDP?

- Goods and services not sold in the market are not counted in GDP – Non market production.
- Some activities or transactions in the economy are never recorded in the informal sector. An example is illegal activities.
- Data used is not always as accurate as it could be, so values are often revised and adjusted.
- GDP has no indicator of economic welfare. This means that R100 million spent on military goods and hardware is measured in the same way that R100 million would be measured when spent on education.

Question 2 (16)

(2a) Use a diagram to explain how an increase in the tax rate will influence the income level in the economy, given that the price level is fixed. (3)



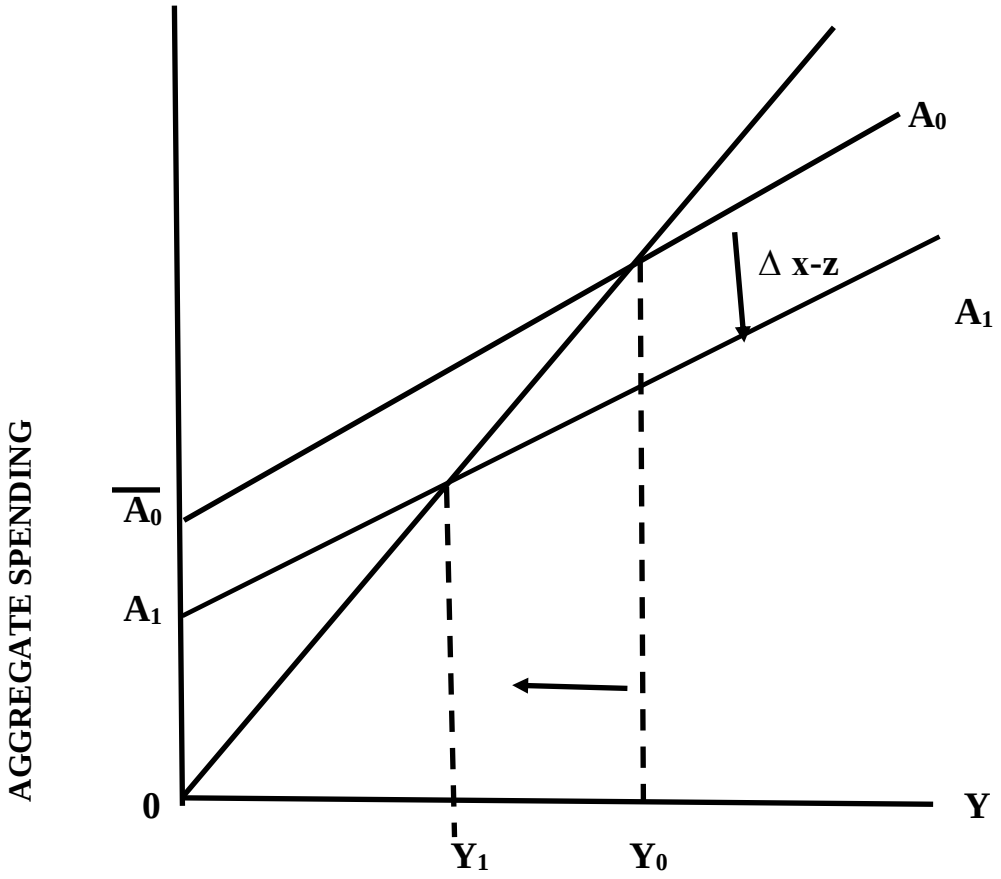
TOTAL PRODUCTION AND INCOME

Explanation:

With an increase in the tax rate the aggregate spending curve swivels downwards from A_0 to A_1. The income level will decrease from Y_0 to Y_1.

2b) Due to a change in trade policy, there has been a substantial decrease in the amount of steel produced in South Africa and an increase in the amount of steel imported into South Africa. This has led to a substantial increase in total imports. Explain how this will affect the economy by making use of the Keynesian model. Also mention how this will affect employment in South Africa. (4)

A **A = Y**

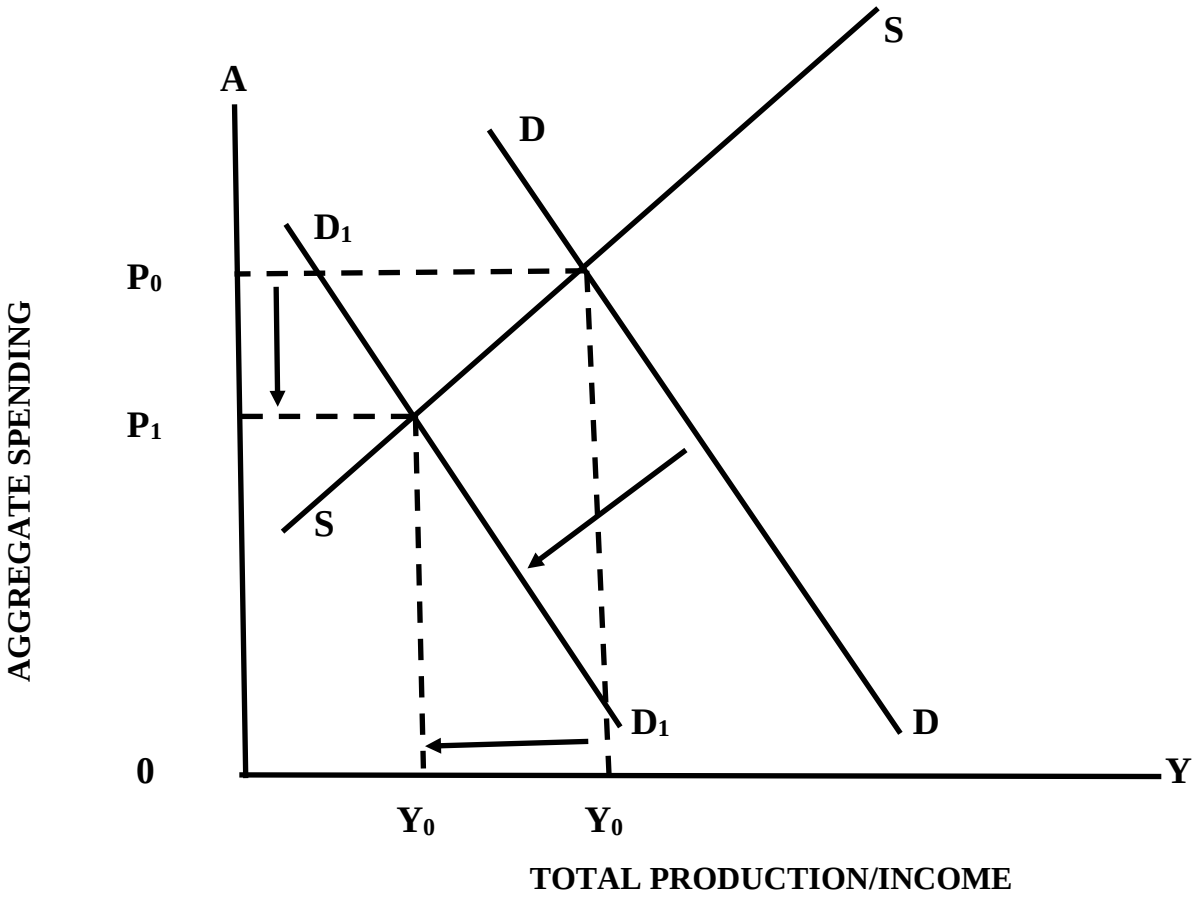


TOTAL PRODUCTION AND INCOME

Explanation:

With an increase in imports the aggregate spending curve shifts downwards from A_0 to A_1. The income level will decrease from Y_0 to Y_1. With the decrease in total production/income unemployment will increase

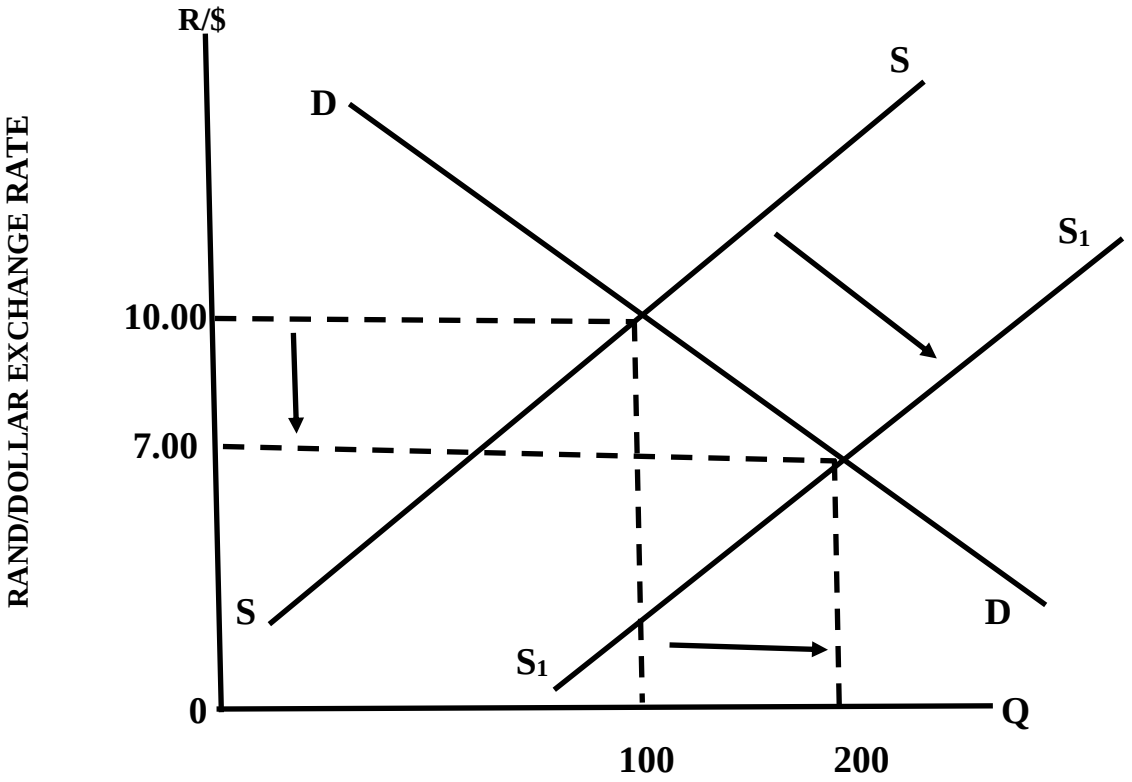
(2c) Use the AD-AS model to explain the effect of an increase in the interest rate level in the economy. (4)



Explanation:

With an increase in the interest rate investment spending will decrease. This will impact on the aggregate demand curve which will shift to the left from D to D_1. The result is that total production/income will decrease from Y_0 to Y_1. . The price level will decrease from P_0 to P_1,

(2d) In the year 2022 Durban will host the Common Wealth Games, which is expected to cause a substantial increase in foreign tourists visiting the country. Explain with the aid of a diagram how you would expect this to influence the rand/dollar exchange rate. Also explain (but not with a diagram) how you would expect imports and exports to be affected by this change in the exchange rate. (5)



Explanation:

With the increase in foreign tourists in 2022 the supply of dollars will increase**.** This will shift the supply to the right from S to S_1. The quantity of dollars will increase from 100 to 200 and rand will appreciate from R10.00 to R7.00.

The price of exports will increase relative to South Africa's foreign competitors, so exports will decrease. However imports become cheaper which will be to the benefit of the South African citizens.

Question 3 (10)

(3a) The following figures were obtained from the *Quarterly Labour Force Survey* (Quarter 2, 2015 edition) compiled by Statistics South Africa: April to June 2015 (thousands)

Population aged 15 to 64 years	**35 955**	
Labour force		**20 887**
Employed		***15 657***
Formal sector (including agriculture and		**12 996**
private households)		**2 661**

Informal sector

Unemployed	***5 230***
Not economically active	**15 068**
Discouraged work-seekers	**2 434**
Other (not economically active)	**12 633**

(i) Calculate the unemployment rate according to the strict definition of unemployment. (2)

According to the strict definition, unemployed persons are those persons who, being 15 years and older,

a. are not in paid employment or self-employment,
b. were available for paid employment or self-employment during the seven days preceding the interview, and
c. took specific steps to during the four weeks preceding the interview to find paid employment or self-employment.

The expanded definition omits requirement (c). In other words, the expanded definition requires only a desire to find employment.

20 887(Labour force) plus 2434 (discouraged workers) = 23321

Unemployment rate = $\frac{\textbf{Number of unemployed}}{\textbf{Economically active population (People willing and able to work)}}$

Unemployment rate = $\frac{\textbf{5230}}{\textbf{23321}}$ **X 100**

= 22.43%

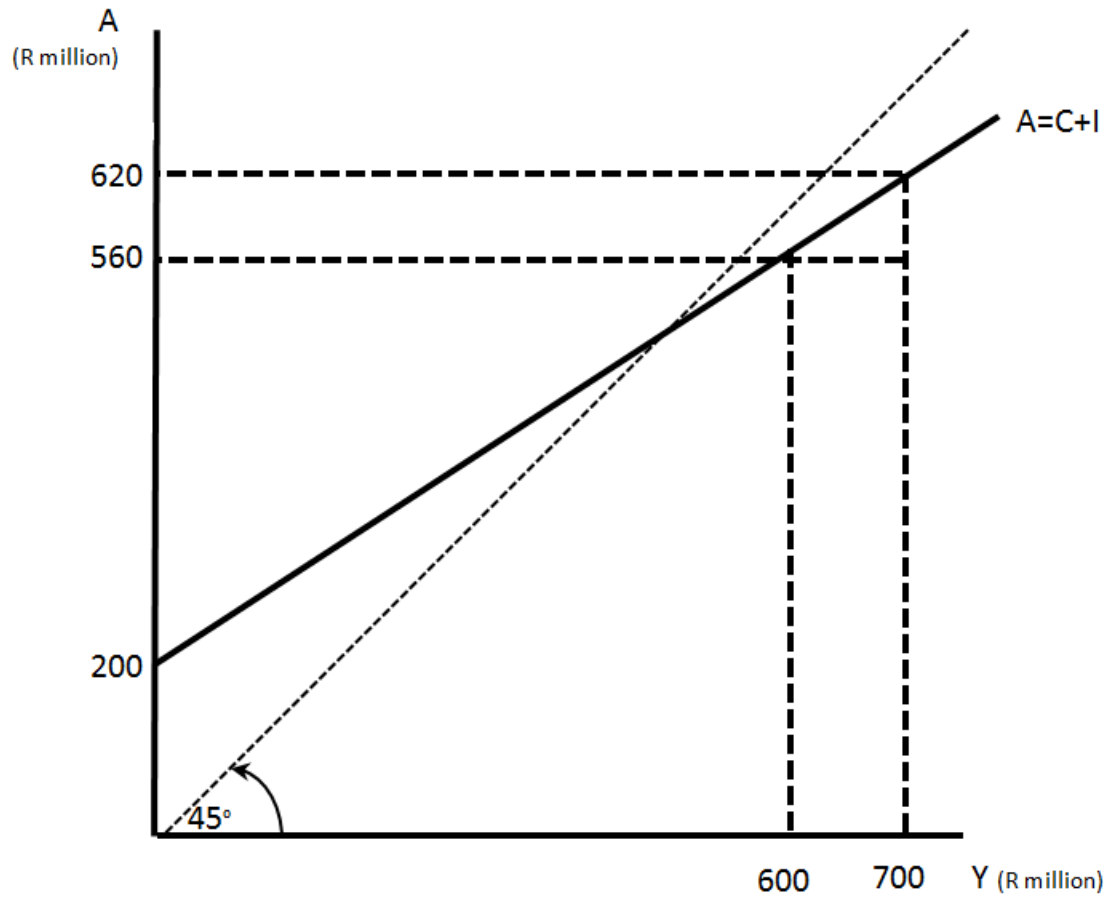
(ii) Calculate the unemployment rate according to the expanded definition of unemployment. (2)

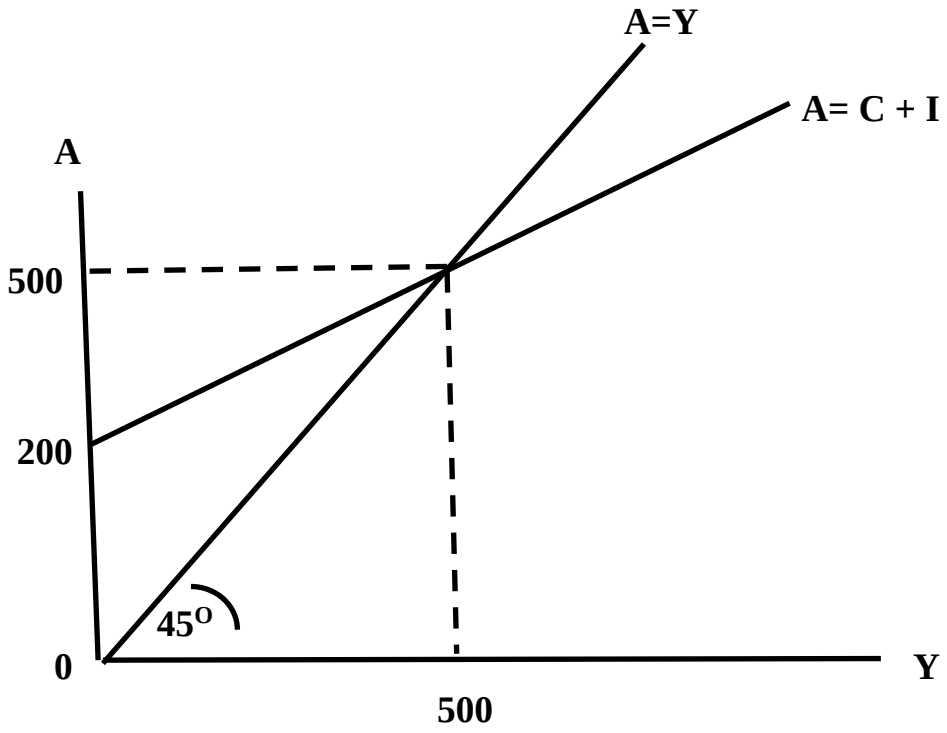
The expanded definition omits requirement (c). In other words, the expanded definition requires only a desire to find employment. (discouraged workers excluded)

Unemployment rate = $\frac{\textbf{5230}}{}$ **X 100**

$$= \frac{20887}{25.04\%}$$

(3b) Use the information in the following diagram of the Keynesian model to answer the questions that follow: (THIS GRAPH IS OUT OF SYNC. I HAVE GIVEN YOU ANOTHER EXAMPLE.





(i) Calculate the marginal propensity to consume. (2)

$$MPC = \frac{\Delta A}{\Delta Y}$$

$$\frac{A_2 - A_1}{Y_2 - Y_1}$$

$$\frac{500 - 200}{500 - 0}$$

$$\frac{300}{500}$$

$$\frac{3}{5}$$

0.60

(ii) Calculate the multiplier. (2)

$$\alpha = \frac{1}{1 - c}$$

$$\alpha = \frac{1}{1 - 0.60}$$

$$\alpha = \frac{1}{0.40}$$

$$\alpha = 2.50$$

(iii) Calculate the new equilibrium income level if investment increases by R100 million. (2)

$Y_0 = \alpha \overline{A}$ $\overline{A} = 200 + 100 = 300$

$Y_0 = 2.50 \times 300$

$Y_0 = 750$

Question 4 (11)

(4a) During the month of August 2015, the exchange rate of the rand changed as follows:

Date	**R/$**
3 August 2015:	**12,73**
31 August 2015:	**13,34**

Indicate if this change represents a depreciation or an appreciation of the rand and explain how this change in the exchange rate will affect the current account of the balance of payments. (4)

The rand has become more expensive relative to the dollar. This means that the rand has depreciated against the dollar. On the 3rd August it cost R12.73 for 1$. On 31st August it cost R13.34 for $1. Exports will be relatively cheaper than foreign competitors so the supply of dollars will increase which causes a surplus in the current account. However, South Africa imports more than it exports imports. Imports are now more expensive and the demand for dollars will result in a deficit in the current account.

(4b) Describe the effect of an increase in government expenditure on the economy. Clearly explain why the increase in income exceeds the increase in government expenditure. (5)

If government spending increases this will shift the aggregate spending curve upward. The result is an increase in total production/income. The reason why the change in total/production is greater than the change in Government spending is due to the multiplier effect.

(4c) Explain why the multiplier for an open economy is smaller than the multiplier for a closed economy. (2)

The multiplier in an open economy includes two extra variables t which is taxes and m which is the marginal propensity to import. In the closed economy assuming no government the variables are excluded and only c which is the marginal propensity to consume is used. Both taxes and imports are leakages from the economy and are a function of income.

ECOS 1601 EXAM PAPER OCTOBER/NOVEMBER 2015

Question 1 **(12)**

(1a) Briefly explain two policies that may be used to decrease unemployment which focus on increasing the demand for labour (2)

Policies to combat unemployment

Demand side steps:

- Additional employment opportunities can be created by raising the aggregate demand for goods and services, and increasing the labour intensity of production.
- Increased government spending (expansionary fiscal policy)
- Stimulate consumption and investment spending by lowering taxes or interest rates.
- Raise the demand for domestically produced goods and services by increasing the demand for exports
- Promoting labour intensive industries and labour-intensive production methods.
- Special employment programmes such as building dams, sports stadiums, etc.
- Promoting small businesses and the informal sector.
- Offering tax incentives or subsidies to firms to stimulate employment.

(1b) Distinguish between cyclical unemployment and structural unemployment (2)

- **Cyclical** – this type of unemployment is triggered by the natural cycle of modern economies. As the economy enters a downturn, so production dips and jobs are lost. As a result, unemployment rises. In theory this is a temporary problem since the economy will pick up again and when it does, the process will reverse itself.

- **Structural** – this form of unemployment arises when there is a mismatch between worker qualifications and job requirements. In other words, it is unemployment that arises due to certain skills development and additional training being required to equip the candidate with the ability to do the job advertised.

(1c) Explain why an increase in nominal GDP does not necessarily imply that economic growth has taken place (2)

This is because in nominal GDP inflation is included. To get real GD we need to subtract the inflation from nominal GDP. This will then tell us whether there has been any economic growth.

(1d) List three criteria for a good tax system (3)

1. Neutrality

2. **Equity**

3. **Administrative simplicity**

(1e) List three functions of the South African Reserve Bank (3)

1. **Formulation and implementation of monetary policy.**

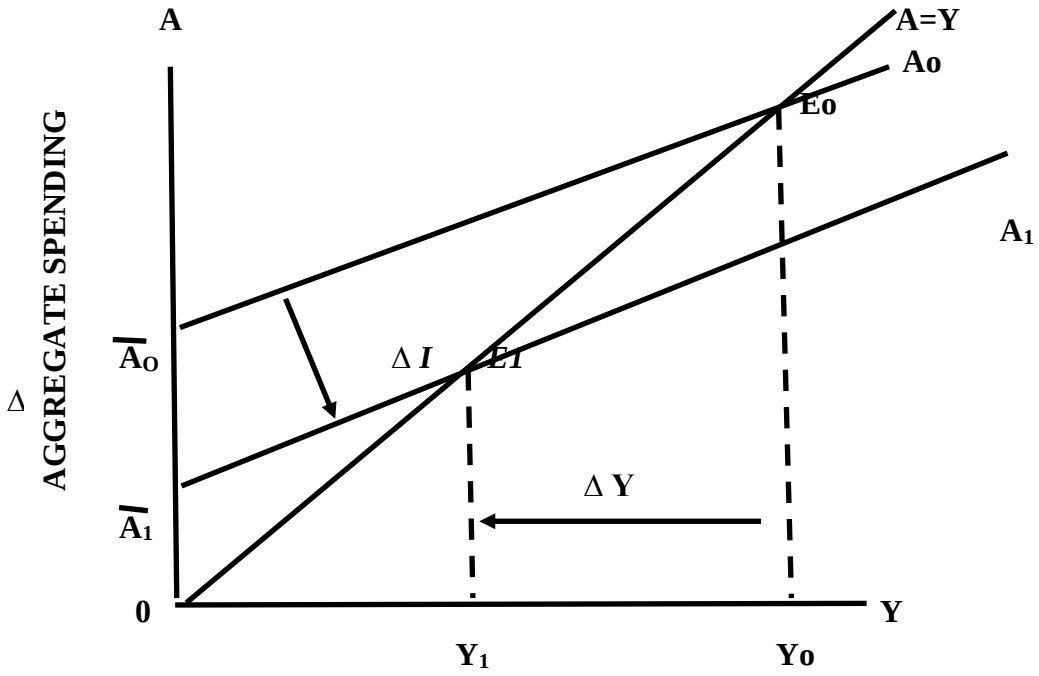
2. **Service to the government.**

3. **Provision of economic and statistical services.**

4 **Maintaining financial stability**

on 2 (13)

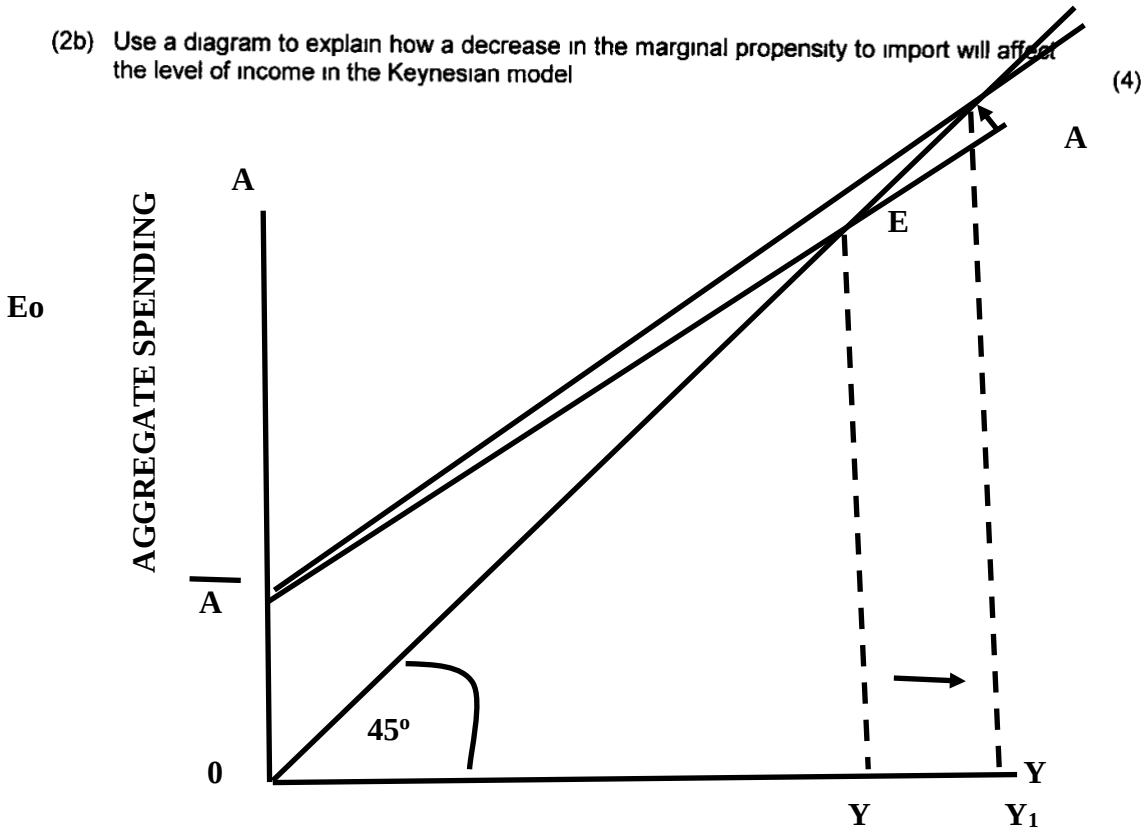
se a diagram to explain how a decrease in investment due to an increase in the terest rate level will affect the level of income in the Keynesian model (4)



TOTAL PRODUCTION AND INCOME

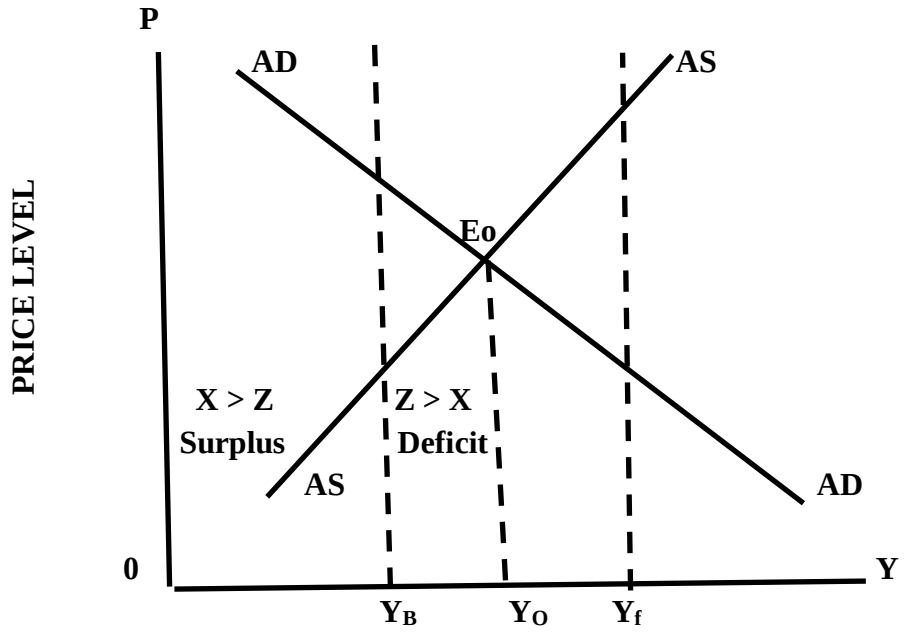
Investment spending is a function of the interest rate. If the interest rate increases then investment spending will decrease and the aggregate spending curve will shift downwards from Ao to A_1. This will result in a reduction in total production and income which decreases from Yo to Y_1

(2b) Use a diagram to explain how a decrease in the marginal propensity to import will affect the level of income in the Keynesian model (4)



The A curve shows the components of aggregate spending (C,*I*,G) before the introduction of the foreign sector. . With the marginal propensity to import decreases it will impact on the slope of the A curve and it will swivel upwards to A_1. Total production/Income will increase from Y to Y_1

(2c) South Africa experienced a current account deficit of R2 300 million in the third quarter of 2014 and 24,3% of the South African labour force was unemployed Use an AD-AS model to illustrate and explain how this situation creates a policy dilemma (5)



TOTAL PRODUCTION/INCOME

The equilibrium level of income Yo is determined by the aggregate demand curve and aggregate supply curve. Y_B indicates the level of income where exports X equal imports Z. Y_f indicates full employment. At Yo there is unemployment and a deficit on the balance of payments. If aggregate demand were to increase to try and reach full employment then the deficit on the balance of payments will increase. If aggregate demand was to decrease to reduce the deficit on the balance of payments then unemployment would increase. This is the policy dilemma.

Question 3 **(10)**

Questions 3a, 3b and 3c are based on the following

The marginal propensity to consume of the population of the Republic of Banama is 0,75 Currently autonomous consumption is equal to 8 500 Bans and investment is equal to 4 500 Bans The full employment level of income is 115 000 Bans

(3a) *Calcuate the current equilibrium income level* (5)

$Yo = \alpha \bar{A}$ $\bar{A} = \bar{C} + \bar{I}$ $\bar{A} = 8500 + 4500 = 13000$

$\alpha = \frac{1}{1 - c}$ $\alpha = \frac{1}{1 - 0.75}$ $\alpha = \frac{1}{0,25}$

$\alpha = 4$

$Yo = 4 \times 13000$

$Yo = 52000$

(3b) By how much should government expenditure increase to reach the full employment level of income? (3)

$\Delta G = \frac{Y_f - Yo}{A}$ $\Delta G = \frac{115000 - 52000}{4}$ $\Delta G = \frac{63000}{4}$ $\Delta G = 15750$

(3c) Calculate the marginal propensity to save of the Republic of Banama (2)

$MPS = 1\text{-}MPC$ $MPS = 1 - 0.75$ $MPS = 0.25$

Question 4 **(15)**

(4a) In the 2015/16 budget is was announced that the general tax rate was increased by 1% Explain how this increase of the general tax rate will affect the following variables in the Keynesian model

(i) consumption
(ii) the multiplier
(iii) the equilibrium income level (6)

(i) Consumption will decrease because there will be less disposable income to spend.

(ii) The multiplier will be affected because of tax rate is now included in the multiplier in addition to c (MPC). The multiplier will decrease.

(iii) With an increase in the tax rate of 1% the aggregate spending curve will swivel downwards as tax impacts on the slope of the aggregate spending curve. The equilibrium income level will decrease.

(4b) Explain how expansionary monetary policy will influence the price level and the equilibrium income level in the economy in the framework of the AD-AS model (7)

When there is an expansionary monetary policy the main instrument that the SARB uses is the interest rate which will be decreased. The aggregate spending curve will shift to the right. The equilibrium level of income will increase but the price level will also

increase. This means the total production/income and employment have increased but at the expense of inflation.

(4c) Will the size of the marginal propensity to consume affect the monetary transmission mechanism? Explain your answer (2)

No. Investment spending is a function of the interest rate. The monetary transmission mechanism is triggered off by a change in the interest rate which impacts on investment spending, which is autonomous and not dependent on income.

SECTION B
MCQS OCTOBER/NOVEMBER 2015

QUESTION	ANSWER
1	3
2	3
3	2
4	1
5	3
6	4
7	5
8	2
9	2
10	4
11	4
12	1
13	4
14	1
15	2
16	1
17	4
18	2
19	2
20	3
21	1
22	2
23	3
24	2
25	3
26	
27	2
28	2
29	2
30	3
31	2
32	1

33	4
34	2
35	3
36	1
37	5
38	2
39	3
40	3

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QUESTION 1 **(10)**

(i) Briefly explain the difference between gross domestic expenditure (GDE) and expenditure on (GDP). (4)

GDP measures the total value of all goods and services produced within the borders of a country doing a specific period.

GDE measure to the total value of spending within the borders of a country during a specific period. It includes imports (Z) and excludes exports (X)

(ii) Name two measures that are used to measure inequality (2)

(i) Lorenz curve
(ii) The Gini Coefficient
(iii) Quantile ratio

(iii) Give two reasons for the growth in government spending in South Africa since 1960 (2)

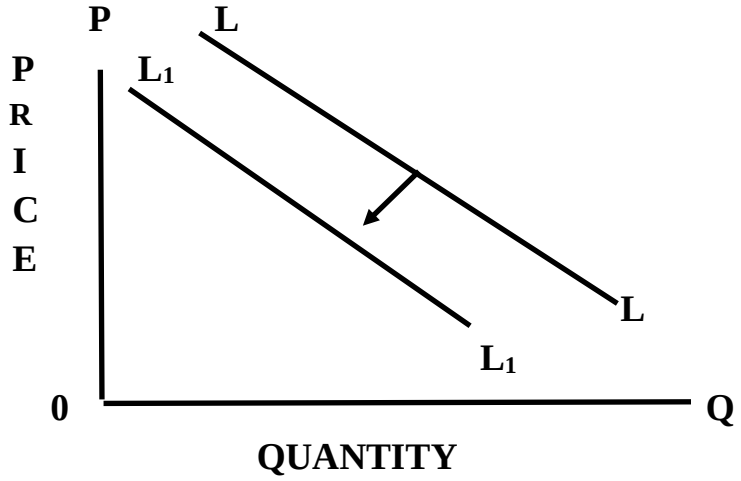
Old text book
New text book 1990/1991 and 2012/2013 (general services, Protection services like defence and Police, Social services like education and health)

(iv) Name two market oriented monetary policy instruments. (2)

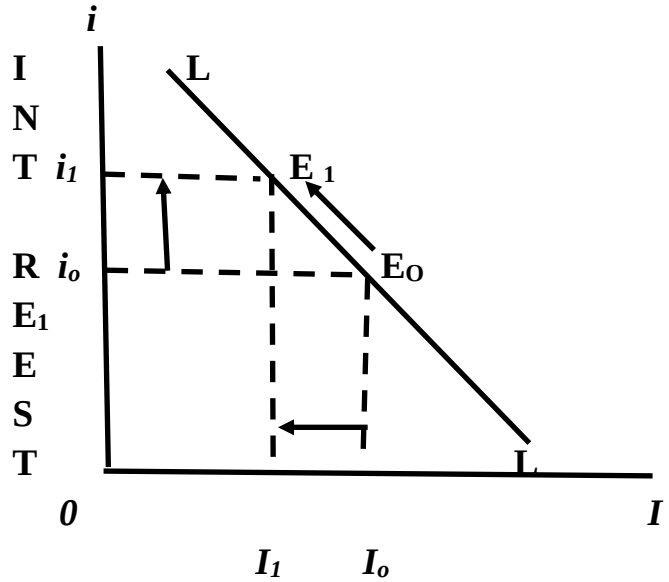
(i) Buy or sell government bonds or other securities to banks
(ii) Interventions in the foreign exchange markets
(iii) Public debt management.

QUESTION 2

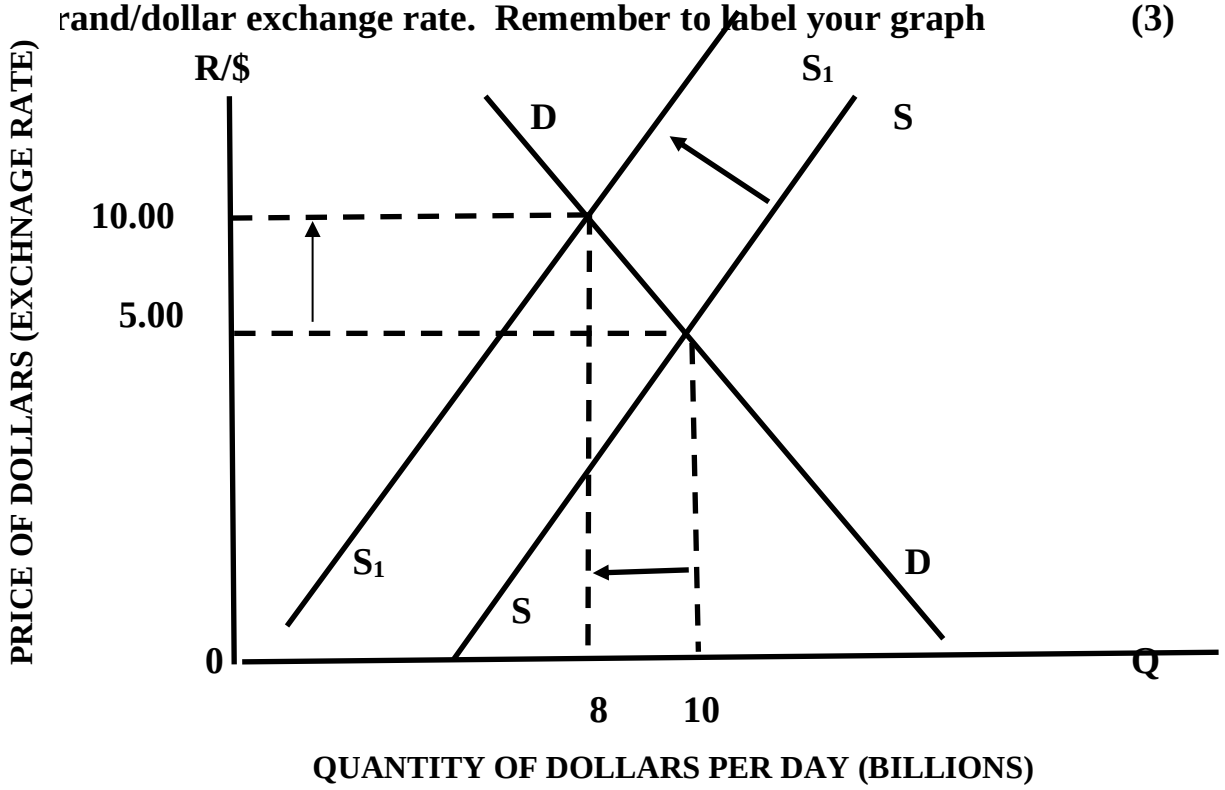
(i) Use the following diagram to show what happens with the demand for money if the South African economy experiences a recession. Remember to label your diagram (3)



(ii) Use the following diagram to show what happens with the demand for money is monetary authorities increase the repo rate. Remember to label your diagram (3)



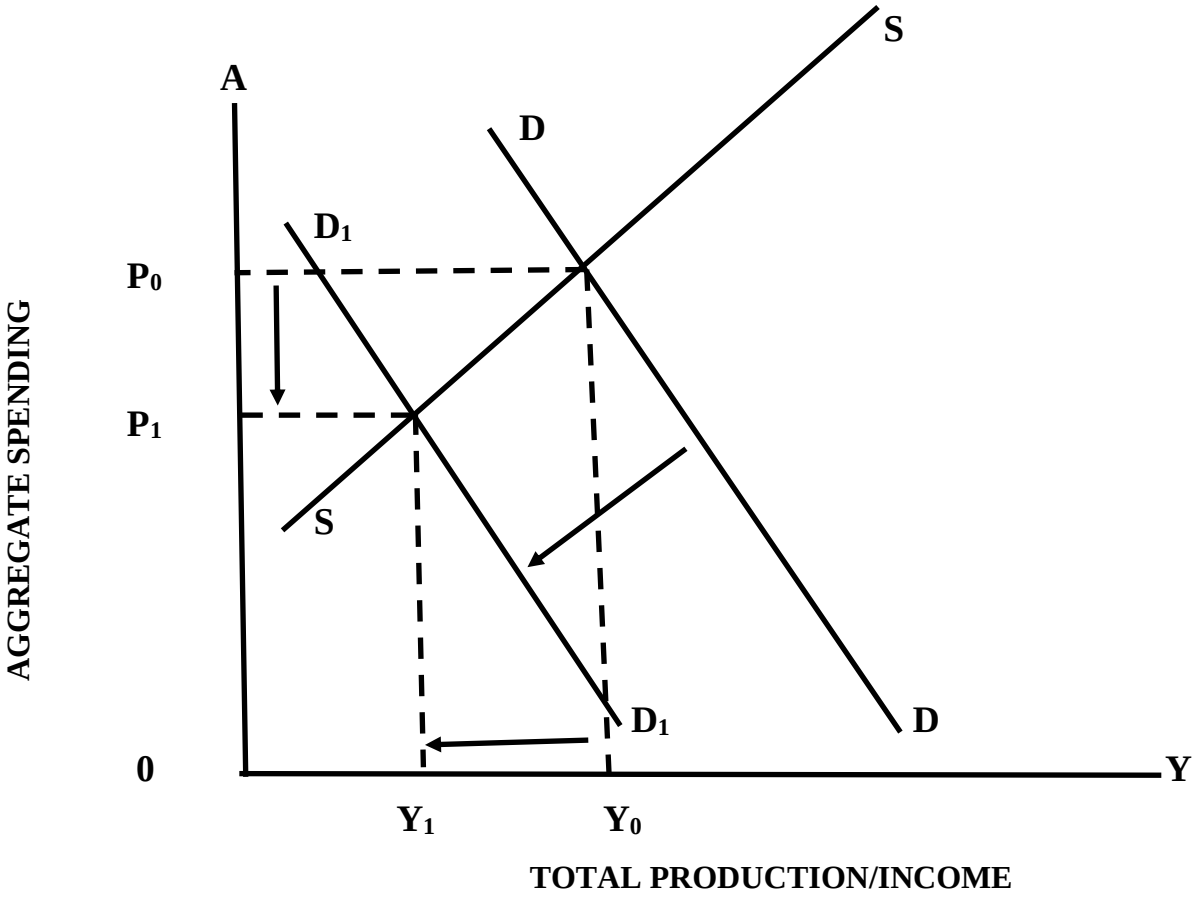
(Illustrate on the following diagram the impact of an economic recession in the economies of South Africa's trading partners on the rand/dollar exchange rate. Remember to label your graph (3)



(iv) Given the Keynesian model of an open economy, illustrate on the following diagram the impact of an increase in the marginal propensity to import on the equilibrium level of income. Remember to label your graph. (3)

SAME AS OCTOBER/NOVEMBER. 2015

(v) Use the following diagram to illustrate the effect of an increase in interest rates on prices and income in the AD-AS model. Remember to label your graph. (3)



QUESTION 3

(i) Given the following information

C = 100+ 0,75Y

Y = 2000

Calculate (Show all your formulas and calculations)

(i) Induced consumption If Y = 2000 (2)

Formula for induced consumption = cY c = 0,75 Y = 2000

cY = 0.75 x 2000 = 1500

(ii) Savings if Y = 2000

Formula for savings = S+ sY s = 0.25 Y = 2000
sY = - 100 (0.25 x 2000)
sY = 400

(iii)The following information about a Keynesian model is given

Autonomous consumption spending	**R250 mill**
Investment spending	**R150 mill**
Marginal propensity to consume	**4/5 (0.80)**
Full level of employment	**R1 500**

Calculate (Show all your formulas and calculations

- **The autonomous spending (2)**
  $\overline{A} = \overline{C} + \overline{I}$ $\overline{A} = 250 + 150 = 400$

- **The multiplier (2)**
  Formula for multiplier in an economy without government.
  $\alpha = \frac{1}{1 - c} = \frac{1}{1 - 0.80} = \frac{1}{0.20} = 5$

- **The equilibrium level of income (2)**
  $Y_o = \alpha \overline{A} = 5 \times 400 = 2000$

- **By how much must investment spending increase to bring about full employment (2)**

$$\Delta I = \frac{Y_f - Y_o}{\alpha} = 1500 - 2000 \text{ ??????}$$

QUESTION 4

(i) Briefly explain the possible impact of appreciation in the rand/dollar exchange rate on the balance of payments in South Africa (4)

If the rand appreciates against the dollar it would mean that South African goods and services will become relatively more expensive in relation to their foreign competitors so exports will decrease. On the other hand imports will increase because of the appreciation of the rand. The final result is that there will be an increase of the deficit on the balance of payments because Z >X.

(ii) Explain why it is that in the simple Keynesian model an increase in government spending has a multiplier effect on the level of income (4)

Suppose government increases its spending to build a dam in Limpopo. When government spends this amount say R1billion the amount spent goes to the workers and owners of the construction companies and in turn to companies that supply materials and equipment to the construction industry. They receive this income in the form of salaries, wages and profit. A process begins whereby the owners and workers of these firm involved in the construction do not put this money in the bank but spend most of it. The amount that they spend will depend on the marginal propensity to consume (*c*) (0.80). Total spending in the economy will therefore increase by R800 mill (0.8 x R1 billion) (Total spending and income has increased by R1.8 billion (original R1 billion plus R800 spent by those who received the original R1 billion) These households then spend this income which raises the income of the workers and owners of the shops and other firms that sell the goods and services to them. Then there will the next round. Where these households spend 0.80 of their new income on goods and service. The ratio between the eventual change in income and initial investment is called the multiplier. (

(iii)Explain how money policy can be used to combat demand-pull inflation (5)

If there is demand – pull inflation in an economy the South African Reserve bank can implement a monetary policy of increasing the interest rates (repo rate). The increase in the interest rate will result in the AD curve shifting to the left. The impact of this shift will be that the price will decrease which means that inflation decreases but this will be

at the expense of total/production and income which will decrease. This will result in an increase in unemployment.

SECTION B

MCQS MAY/JUNE 2015

QUESTION	ANSWER
1	4
2	3
3	4
4	1
5	2
6	1
7	3
8	3
9	3
10	2
11	1
12	1
13	2
14	3
15	2
16	1
17	4
18	1
19	4
20	2
21	1
22	3
23	1
24	3
25	1
26	3
27	3
28	4
29	2
30	4
31	2
32	1
33	4
34	4
35	3
36	3
37	4
38	1
39	1
40	2

ESCOS 1601 EXAM PAPER OCTOBER/NOVEMBER 2014

SECTION A
QUESTION 1

(i) Define the Gross Domestic product (GDP) (4)
Gross domestic product is the total value of all the final goods and services produced within the boundaries of a country in a particular time period (usually one year)

(ii) Define fiscal policy (3)
Fiscal policy which is controlled by the refers to the use of government spending, taxation and borrowing to affect economic activity.

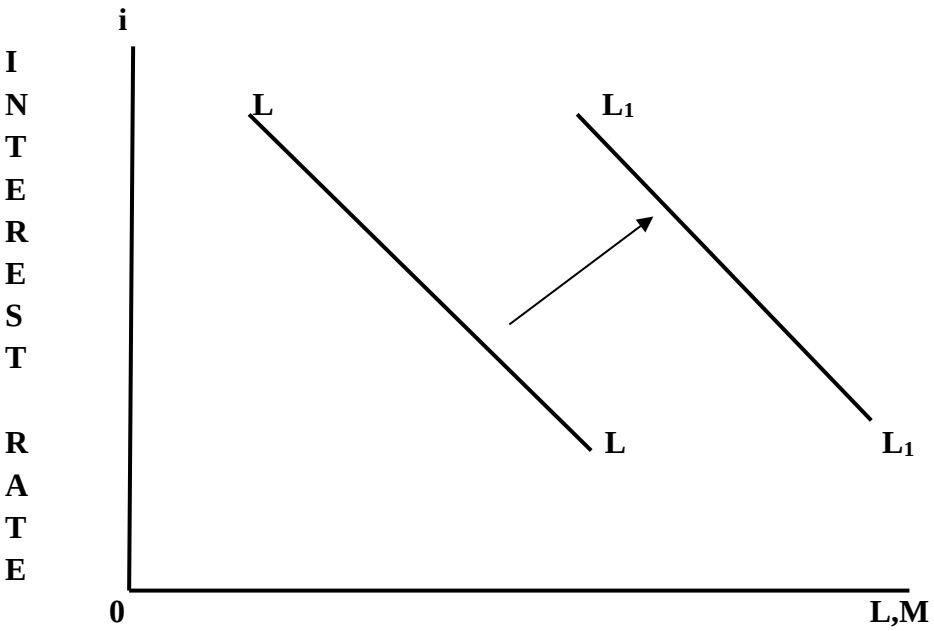
(iii) **What are the two main sub-accounts of the balance of payments? (2)**
The current account and the financial account

(iv) What are the main sources of economic growth viewed from the demand side? (3)

- **Domestic demand (C, I, G)**
- **Export demand (X)**
- **Import substitution (reduce Z)**

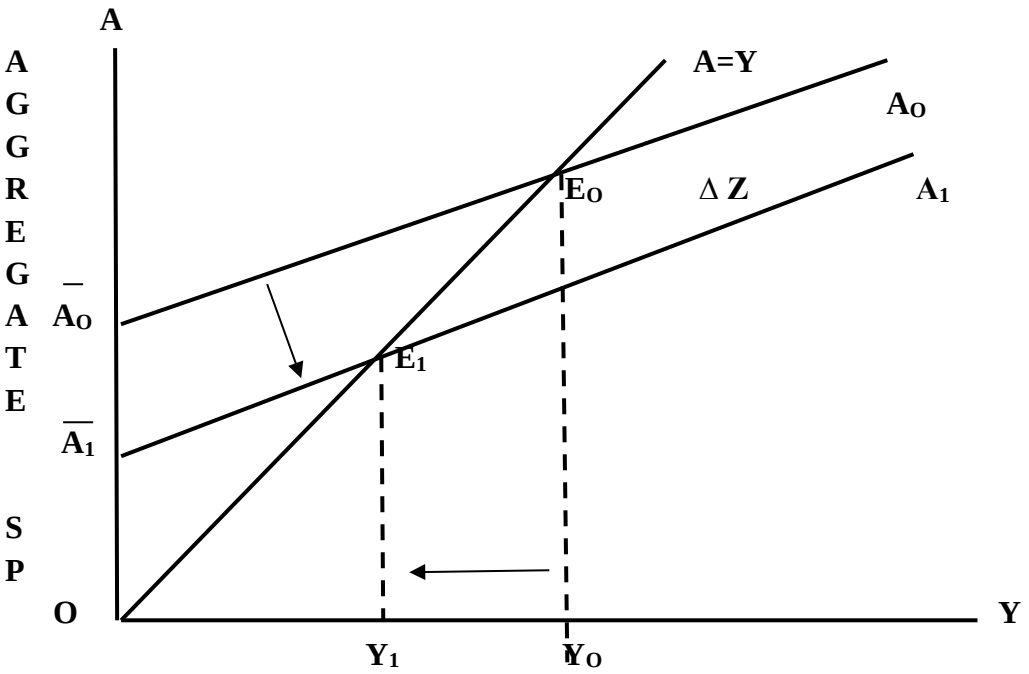
QUESTION 2

(i) Use the following diagram to show how the equilibrium in the money market changes if the Gross Domestic increases. (Remember to label your diagram). (3)



QUANTITY OF MONEY

(ii) Given the Keynesian model of an open economy, illustrate on the following diagram the impact of an increase in autonomous imports on the equilibrium level of income. Remember to label your graph. (3)

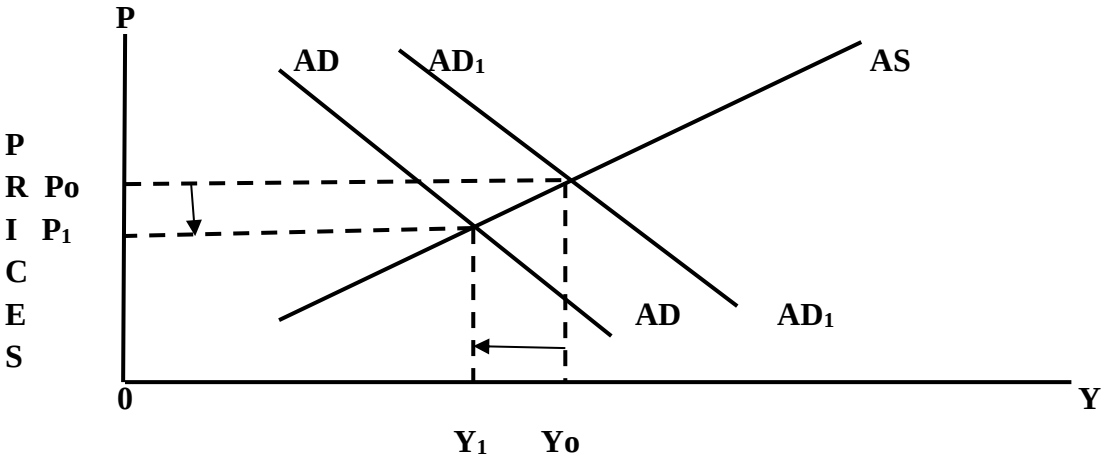


TOTAL PRODUCTION /INCOME

(iii) Given a Keynesian model of an open economy, illustrate on the following diagram the impact of an increase in the marginal propensity to import on the equilibrium level of income. Remember to label your diagram (3)

SAME AS OCTOBER AND NOVEMBER 2015

(iv) Use the following diagram to illustrate the effect of an increase in interest rates on prices and production in the AD-AS model. Remember to label your diagram. (4)



TOTAL PRODUCTION/INCOME

QUESTION 3

(i) Given the following information

In a country with a population of 75 million people there are 19 million children under the age of 15 years, 26 million employed, 8 million pensioners, 6 million unemployed and 1 million full time students. Calculate (show the formula and your calculations (2)

The unemployment rate

$$\text{Unemployment rate} = \frac{\text{unemployed}}{\text{All the people who are willing and able to work.}} \times 100$$

$$= \frac{6 \text{ mil}}{32 \text{mil}} \times 100$$

$$= 18.75\%$$

(ii) Given the following information

C = 100 + 0.8Y

Y = 2000

Calculate (show all your formulas and calculations (2)

- **Induced consumption: if Y = 2000**
  cY = 0.80 X 2000 = 1600

- **Consumption spending if Y = 2000 (2)**
  C = 100 + 1600 = 1700

- **Savings if Y = 2000 (2)**
  S = -100 + 0.20 X 2000 = 300

(iii) Given the following information (2)

C = 400 + 0.60Y

I = 500

Calculate the Multiplier

$$\alpha = \frac{1}{1 - c} = \frac{1}{1 - 0.60} = \frac{1}{0.40} = 2.50$$

(iv) The equilibrium level of income (2)

Yo = $\alpha \overline{A}$ $\overline{A} = \overline{C} + \overline{I}$ $\overline{A} = 400 + 500 = 900$

Yo = 2.50 X 900 = 2250

QUESTION 4

(i) Explain the impact of an increase in the tax rate on the equilibrium level of income in a Keynesian model of an economy. (4)

If there is an increase in the tax rate this will result in the aggregate spending curve swivelling downwards. The equilibrium level of income will decrease. This means that spending will decrease and this will impact on unemployment which will increase.

(ii) **Explain using a Keynesian model of the economy why the decrease in economic activity in Europe had a negative effect on the level of employment in South Africa (5)**

If there is a decrease in the economy in Europe who is one of South Africa's major trading parties there will a decrease in spending in Europe. The impact is that they will not import goods from South Africa which means exports decrease. This will cause a downturn in the South African economy and unemployment will rise.

(iii) Explain how monetary policy can be used to combat inflation (5)

The SARB formulates and implements the monetary policy. Their main instrument to combat inflation is the interest rate. To dampen spending which is causing the high inflation rate the SARB will increase the interest rate. This means that there will be less money to spend so inflation will drop. However it will be at the expense of reduced total production and income and unemployment will rise.

SECTION B
MCQS 0CTOBER/NOVEMBER 2014

QUESTION	ANSWER
1	1
2	2
3	3
4	2
5	3
6	3
7	1
8	1
9	3
10	2
11	3

12	1
13	2
14	3
15	2
16	2
17	3
18	2
19	2
20	2
21	1
22	3
23	3
24	2
25	2
26	3
27	3
28	2
29	1
30	2
31	2
32	2
33	3
34	4
35	1
36	2
37	4
38	1
39	3
40	2

ECS1601 EXAM PAPER MAY/JUNE 2014

SECTION A

Question 1

In the circular flow of income and spending between firms and households there are three leakages or withdrawals, imports are one such leakage. Name the other two. (2)

i) Savings

ii) Taxes

Question 2

Name two market-oriented policy instruments. (2)

(i) Accommodation policy (refinancing of liquidity requirement)

(ii) Open-market policy

(iii) Public debt management

(iv) Intervention in foreign exchange markets.

Question 3

What are the criteria for a good tax? Name three criteria's and explain one briefly (4)

(iii) **Neutrality**: Taxation should have the minimum possible effect on relative prices. There should be no disincentive to change the owners of the factors of production to change their behaviour due to high taxes.

(iv) **Equity**: To determine what is equitable or fair or who should pay taxes, two principles can be used:

4) **Ability to pay principle:** People should pay according to their ability (level of income). There are two notions of equity **horizontal equity** (people in the same position should pay the same tax) and **vertical** equity (people n different positions should be taxed differently)

5) **Benefit principle:** The people who use the government products and services should pay for this use. These are also called **user charges,** (toll roads, hospital services, university educations and electricity and water)

6) Administrative simplicity: Taxes cost taxpayers. **Compliance costs:** taxpayers have to fill out forms and pay accountants to do this for them. **Administrative costs:** People have to be employed by government to write up tax laws, design tax forms, and collect taxes and asses tax returns.

- **Also note: tax avoidance:** This is the practice of avoiding paying taxes (it is legal but lowers the tax revenue for the government)
- **Tax evasion:** This occurs when people do not pay taxes when they should (vendors at flea markets or people who run their businesses from home e.g. hairdressers' or dressmakers)

Question 4

There are two countries. Alfa and Beta. They can only produce cars and bicycles. The following tables show their production of these two goods

		Opportunity cost /comparative advantage
Alfa	**200 cars or 1200 bicycles:**	**1 : 6 1/6**
Beta	**200 cars or 1400 bicycles**	**1 : 7 1/7**

The president of Alfa wants to trade cars with Beta and asks you if Alfa has an absolute or comparative advantage in the production of cars? (1)

Beta has the absolute advantage in the production of bicycles but equal advantage with Alpha in cars.

From a comparative point of view the opportunity costs for Beta to make 1 car is 7 bicycles, (1/7) (relatively more efficient in producing bicycles or lower cost) and for Alpha to make one car the opportunity cost is 6 bicycles (1/6) therefore Beta has the comparative advantage in bicycles and should produce bicycles and Alfa then has the comparative advantage of cars.

5. Name two types of lags that slow down the impact of monetary and fiscal policy:

(i) The recognition lag
(ii) The decision lag
(v) The implementation lag
(vi) The impact lag (2)

6. Shortly describe the main difference between the consumer price index (CPI) and production price index (PPI)

(i) **CPI:** measures the cost of a representative basket of goods and services to the consumer

(ii) **PPI:** measure the prices at the level of the first significant commercial transaction. Imported goods are measured at the point that they enter the country and not when they are sold to consumers. Manufacturing goods are priced when they leave the factory not when they are sold to consumers.

7. In a country with a population of 75 million people there are 19 million children under the age of 15 years. 26 million employed, 8 million pensioners, 6 million unemployed and 1 million full time students. What is the employment rate? (2)

People who cannot be considered as part of the working force are as follows:

(i) Children under the age of 15 years: 19 million
(ii) Pensioners: 8 million
(iii) Full time students: 1 million
28 million

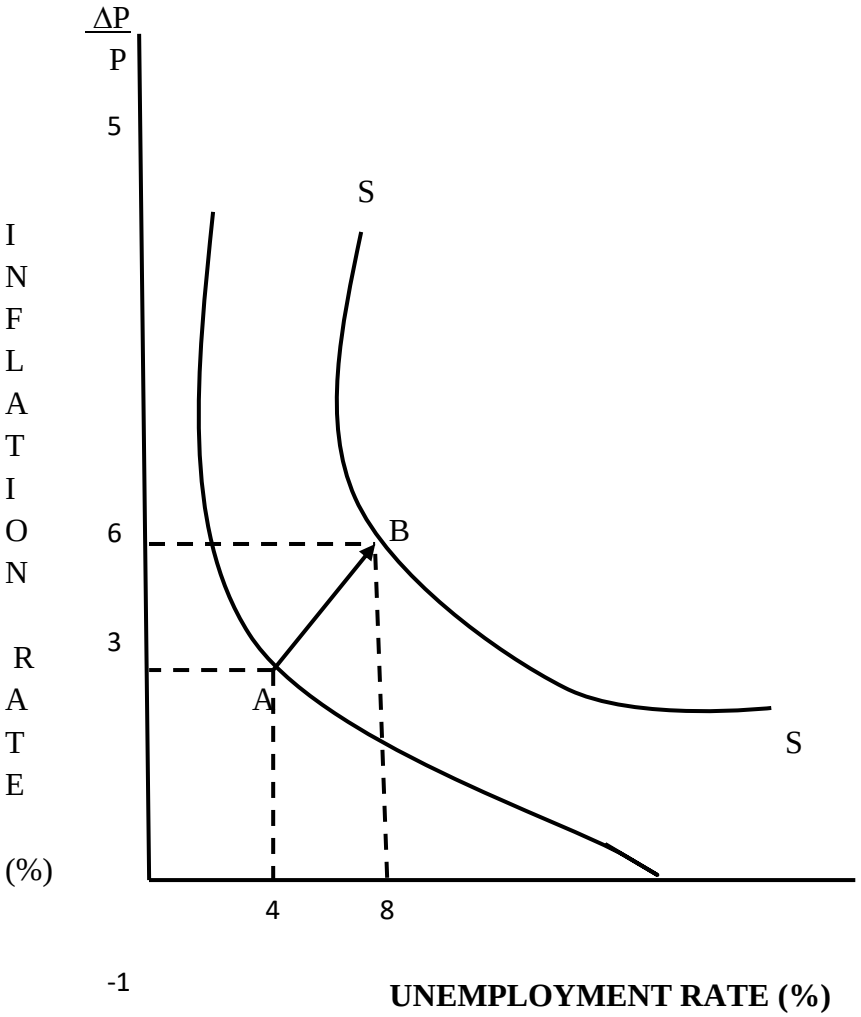
Definition for total labour force: All individuals who ae willing and able to work

(i) Number presently employed: 26 million
(ii) Number presently unemployed: 6 million
32 million

Formula for unemployment rate: $\frac{\text{number of unemployed}}{\text{Total workforce}} \times 100\% = \frac{6 \text{ million}}{32 \text{ million}}$
= 18,75%

8.

8.1 Use the following diagram to draw an example of the Phillips curve (3)



8.2 Which public institution is responsible to keep inflation under control (1)
The South African Reserve Bank.

9.1 Calculate the multiplier for the economy of Neverland. Give the answer in two decimals (2)

$$\alpha = \frac{1}{1- 0.80(1 -0.25)}$$

$$\alpha = \frac{1}{1 - 0.80 \times 0.75}$$

$$\alpha = \frac{1}{1 - 0.60}$$

$$\alpha = \frac{1}{0.40}$$

$$\alpha = 2.50$$

9.2 Calculate the equilibrium income of Neverland (3)

Yo = $\alpha\bar{A}$ $\quad \bar{A} = \bar{C}+\bar{I}+\bar{G}$

= 900 + 300 + 400 = 1600

Yo = αA **2.50 x 1600 = 4000**

9.3 Calculate the fiscal surplus or deficit of Neverland. (2)

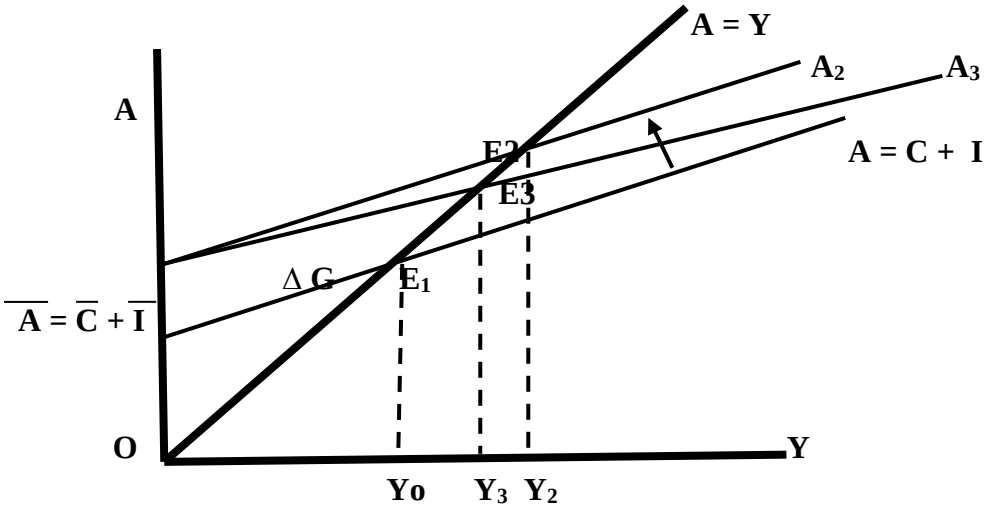
$\bar{G}$ **- T** **T = tY** **T = 0.25 x 4000** **T = 1000**

400 - 1000

Surplus = 600

Question 10

Examine the following graph and use it to answer the following questions.



10.1 Show on the above graph where equilibrium is by indicating it with a dot marked E1 (1)

10.2 After this country elects a government, government expenditure increases from zero. Show what will happen to the Aggregate Spending line, name the new line "A2" (1)

10.3 Show where the new equilibrium is by indicating it with a dot marked "E2"

10.4 The government decides they need to implement a proportional income tax. Show what will happen to the aggregate spending lie (name the new line "A3"). Show the new equilibrium with a dot marked "E3")

QUESTION 11

Make use of the table below, showing the CPI for South Africa for 2012 and 2013 to answer the following questions

	2012	2013
January	**95.2**	**100.3**
February	**95.7**	**101.3**
March	**96.8**	**102.5**
April	**97.2**	**102.9**
May	**97.2**	**102.6**
June		
July		
August		

September		
October		
November		
December		
Average for the year		

11.1 Sandi had an income of R10 206 per month in April 2012, in April 2013 she has an income of R11 320 per month. Did Sandi's nominal income increase? And if so how much? (1)

Yes nominal income will increase

11 320 – 10 206 = 1 114

$\frac{1\ 114}{10\ 206} \times 100 = 10.92\% = 11\%$

11.2 **Did 'Sandi's real income increase? And if so by how much? Only give the rand value, do not round the cents up? (2)**

QUESTION 12

Suppose that an economy produces 3 goods. Their quantities produced for 2000, 2007 and 2012 are shown in the table below.

	2000 (base year)		**2007**		**2012**	
Product	**Quantity**	**Price**	**Quantity**	**Price**	**Quantity**	**Price**
Hotdogs	**100**	**R5**	**150**	**R10**	**170**	**R17**
Pizzas	**50**	**R15**	**100**	**R25**	**95**	**R30**
Hamburgers	**230**	**R10**	**250**	**R15**	**260**	**R22**

12.1 Calculate the nominal gross domestic product (GDP) for 2007 and 2012 (2)

	2007	**2012**
Hotdogs	**150 x 10 = 1500**	**170 x 17 = 2890**
Pizzas	**100 x 25 = 2500**	**95 x 30 = 2850**
Hamburgers	**250 x 15 = 3750**	**260 x 22 = 5720**
	7750	**11 460**

12.2 Calculate real GDP for 2007 and 2012 (2)

Hotdogs	**150 x 5 = 750**	**170 x 5 = 850**
Pizzas	**100 x 15 = 1500**	**95 x 15 = 1425**
Hamburgers	**250 x10 = 2500**	**260 x 10 = 2600**
	4750	**4875**

12.3 Will there be a difference in the real and nominal GDP for the year 2000? Explain (2)

2000 is the base year so the nominal and real values will be the same.

QUESTION 13

During the recession of 2009, countries were confronted with lower output and high unemployment. Therefore, authorities of monetary and fiscal policy decided to enforce expansionary policy.

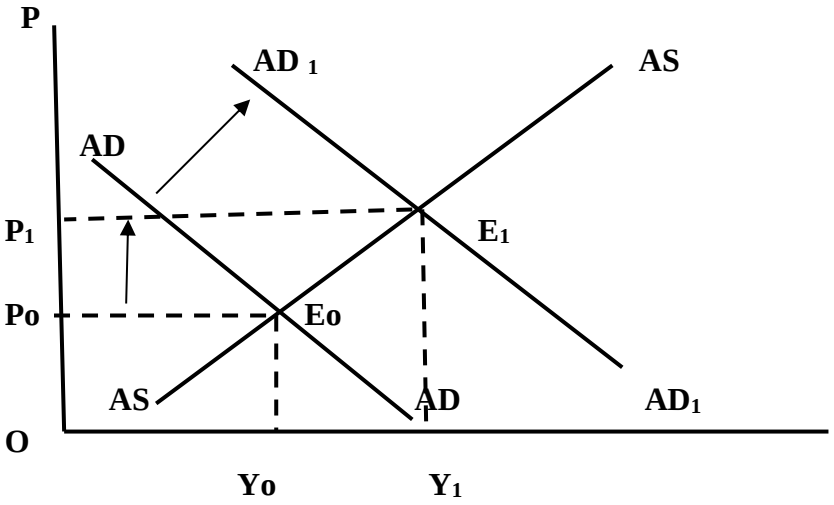
13.1 Explain the term expansionary fiscal policy shortly (3)

The government uses fiscal policy as either a stimulatory or expansionary policy to stimulate economic activities especially in times of recession. The two instruments the government uses are government spending (for an expansionary policy this will mean that government increases its spending) and taxes (for expansionary policy this means that the government can decrease taxes)

13.2 Explain the term expansionary monetary policy shortly (3)

The South African Reserve Bank formulates and implements the monetary policy in South Africa. They use monetary policy to influence the quantity of money or the rate of interest with a view to stabilising prices (combat inflation), full employment and economic growth. If the SARB wishes to implement an expansionary policy its main instrument is the interest rate. (They will decrease the interest to stimulate the economy by encouraging spending)

13.3 **Show on the graph below what the effect of expansionary fiscal and monetary policy will have on the economy. Indicate any movements of the AD and AS curves and show any changes in equilibrium price level and output (3)**



MCQS MAY/JUNE 2014

QUESTION	ANSWER
1	2
2	1
3	1
4	1
5	4
6	4
7	1
8	1
9	3
10	5
11	4
12	1
13	4
14	3
15	4
16	1
17	1
18	5
19	4
20	4
21	2
22	5
23	1
24	3
25	3
26	1
27	2
28	1
29	2
30	2
31	5
32	5
33	3
34	3
35	4
36	1
37	2
38	3
39	5
40	2

ECOS 1601 OCTOBER/NOVEMBER 2013 (50 marks A section and 40 MCQs (1 ¼ MARKS EACH = 50 MARKS) in B section): NOTE IN 2014 MCQS WILL BE 50

QUESTION 1 **(9)**

1.1 Name the main components of fiscal policy **(3)**

- Government spending
- Taxation
- Borrowing

1.2 Name the four functions of the South African Bank **(4)**

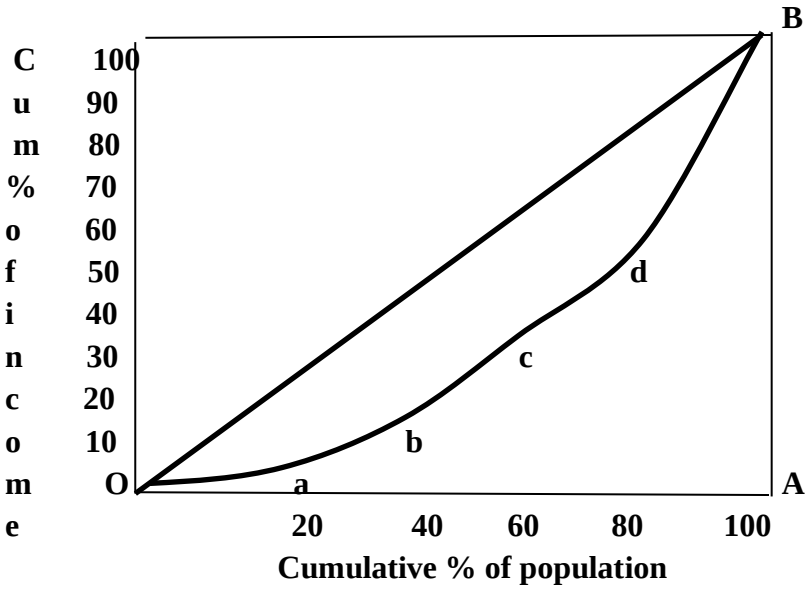
- Formulation and implementation of monetary policy
- Service to the government
- Provision of economic and statistical services
- Maintaining financial stability

1.3 What is the purpose of an import tariff? **(2)**

- Protection of domestic firms against foreign competition (protective tariffs)
- Raise government revenue (Revenue tariffs)

QUESTION 2

2.1 (a) Draw a Lorenz curve depicting a skewed income distribution **(3)**



(b) Describe the calculation of the Gini coefficient **(1)**

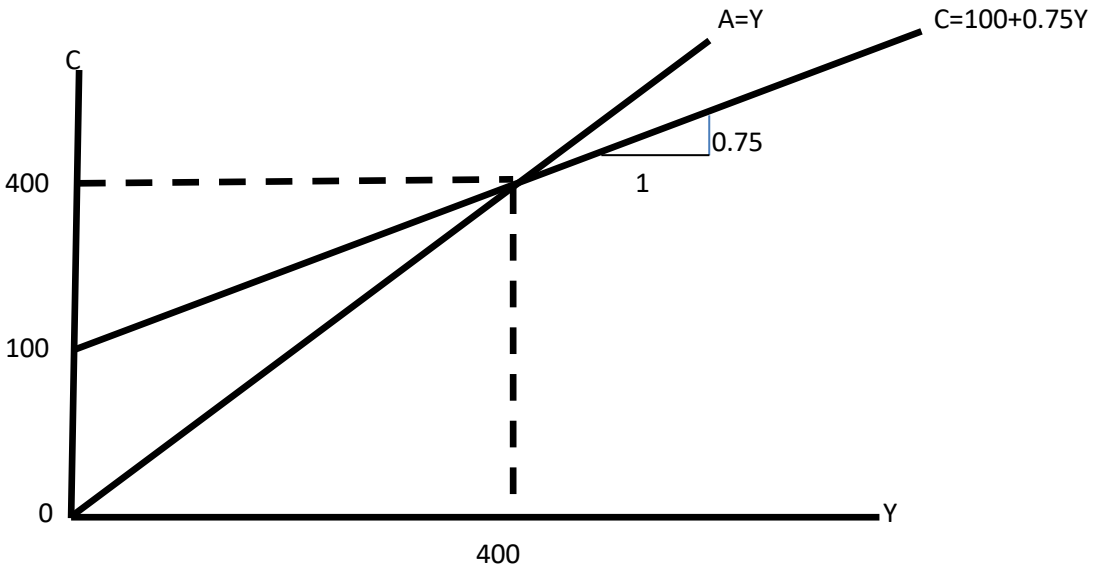
Divide the area of inequality in the Lorenz curve shown above by the area of the right – triangle formed by the axes and the diagonal (line of inequality Points O,A and B in

graph above). The Gini coefficient can vary between 0 and 1. If incomes are distributed equally the Gini coefficient will be zero. If the coefficient is 1 then there is perfect inequality. The Gini coefficient in practice usually varies between about 0.30 (highly equal) and about 0.70 (highly unequal).

2.2 Use the following sets of axes to draw a diagram of each model below. The first one has only households and the second has households and businesses (investors). Clearly indicate the values of the total autonomous expenditure and the equilibrium level of income.

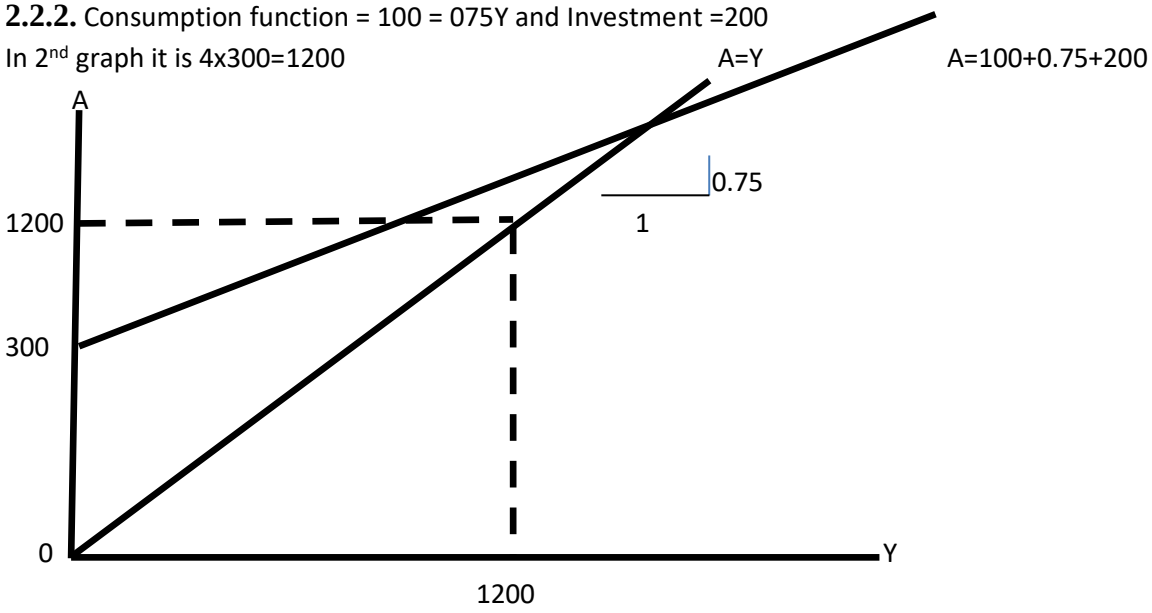
2.2.1 Consumption function = 100 + 0.75Y $\alpha = \frac{1}{1 - c} = \frac{1}{1 - 0.75} = \frac{1}{0.25} = 4$

In first graph it is 4x100 = 400



2.2.2. Consumption function = 100 = 075Y and Investment =200

In 2nd graph it is 4x300=1200



QUESTION 3

You are provided with the following information about an independent island (8)

Autonomous consumption	**150**
Autonomous consumption	**50**
Consumption function	**150+0,5625Y**
Exports	**250**
Full-employment output	**1 900**
Government expenditure	**400**
Investment expenditure	**300**
Marginal propensity to consume	**0.75**
Marginal propensity to import	**0.15**
Tax rate	**0.25**

3.1 Derive the saving function (2)

I think that this is what they want.

If consumption function is C= 150 + 0,5625

Then savings functions is S = -150 + 0,4375Y

3.2 Calculate the multiplier (2)

$$\alpha = \frac{1}{1 - c(1 - t) + m}$$

$$\alpha = \frac{1}{1 - 0,75\,(1 - 0,25) + 0,15}$$

$$\alpha = 1$$

$1 - 0{,}75 \times 0{,}75 + 0{,}15$

$$\alpha = \frac{1}{1 - 05625 + 0{,}15}$$

$$\alpha = \frac{1}{0{,}5875}$$

$\alpha = 1{,}70$

3.3 Calculate the equilibrium level of income. (4)

$Y_o = \alpha \overline{A}$ $\quad \overline{A} = \overline{C} + \overline{I} + \overline{G} + (\overline{X} - \overline{Z})$

$Y_o = 1{,}70 \times 1050$ $\quad \overline{A} = 150 + 300 + 400 + (250 = 50)$

$Y_o = 1785$ $\quad \overline{A} = 1050$

QUESTION 4 (22)

4.1 Explain the use of an open – market policy in increasing the money supply (4)

SARB buys Treasury Bills or Government Bonds from a broker or a financial institution like a bank in the open market. SARB normally puts a bank entry through and increases the cash reserves of this bank. The bank then uses these excess cash reserves to create demand deposits.

4.2 Distinguish between private ownership and privatisation (3)

(i) Private ownership occurs when entrepreneurs own their businesses
(ii) Privatisation is when the government sells one of its nationalised or wholly owned businesses to the private sector

4.3 Explain the main distinctions between savings and investments using the simple Keynesian model. (2)

In the simple Keynesian model firms and household put their money in the form of savings in a financial institute where they earn interest. Investment is spending on capital goods. This is when firms borrow money from financial institutions depending on the interest rate in order to buy these capital goods.

4.4 Explain with reference to the AD/AS model, how a decrease in interest rates affect the price level and income level in the economy. You may use graphs to assist you with the explanation but graphs are not a requirement and will therefore not count to any marks. (5)

When interest rates decrease the demand for investment spending increases. This impacts on aggregate spending and the AD curves shifts to the right. The result is that Total Production/Income increases which means that employment also increases. However prices increase so now inflation will be experienced in the economy.

4.5

4.5.1 Name and describe four types of unemployment (4)

(i) Frictional unemployment: This is when people are between jobs (looking for employment). This type of unemployment is not considered too serious because these people should eventually find employment

(ii) Structural unemployment: This happens when skills are no longer required and jobs become redundant for example ATMs replaced bank tellers or jobs on the mines or in factories are replaced by machines or technology. This is considered very serious because these people do not have other skills that they can use to find current work.

(iii) Seasonal unemployment: Examples would be fruit pickers or fishermen where work is available in season. Another example would be Father Christmases.

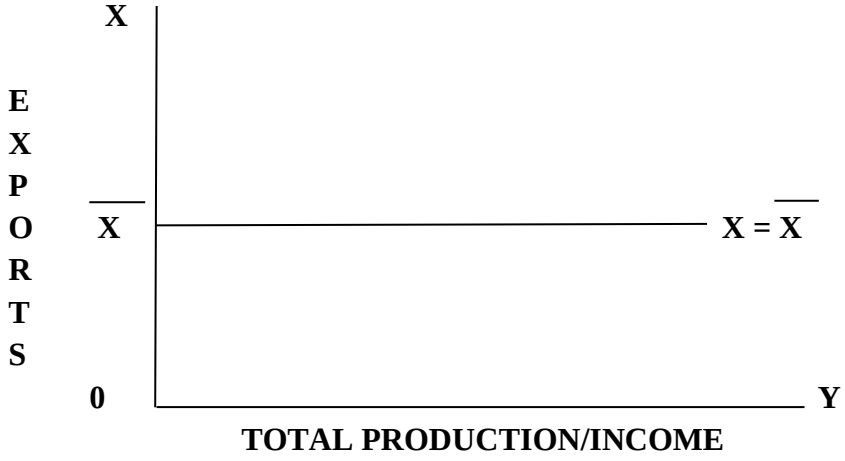
(iv) Cyclical unemployment: This refers to employment that rises and falls depending on the business cycles. When there are upswings or booms in the economy then employment is higher than during downswings and recessions.

4.5.2 Which type of employment do you think is dominant in South Africa? Substantiate your answer. (1)

Structural unemployment because SA labour force is mostly semi-skilled or unskilled so the jobs that are available cannot be done by these people, as their skills are not compatible.

4.6 Explain why exports are viewed as autonomous in the simple Keynesian model of an open economy with a foreign sector and how it is treated in the model. (3)

- Exports are autonomous because they are not dependent on income. $\overline{X}$
- Graphically the relationship between exports and income is illustrated by a horizontal line.


X
EXPORTS
X
X = X
0
Y
TOTAL PRODUCTION/INCOME

MCQS 0CTOBER/NOVEMBER 2013

QUESTION	ANSWER
1	3
2	3
3	4
4	3
5	3
6	4
7	4
8	2
9	4
10	2
11	2
12	4
13	3
14	2
15	3
16	3
17	1
18	3
19	4
20	4
21	2
22	1
23	2
24	1
25	3
26	2
27	2
28	2
29	4
30	2
31	1
32	3
33	3
34	1
35	3
36	3
37	2
38	3
39	1
40	1

ECS1601 MAY/JUNE 2013 EXAM SOLUTIONS

SECTION A

Question 1

i. Define the Gross Domestic Product (GDP)

Total value of all final goods and services produced within the borders of a country in a specific period of time.

ii. Name the three criteria for a good tax

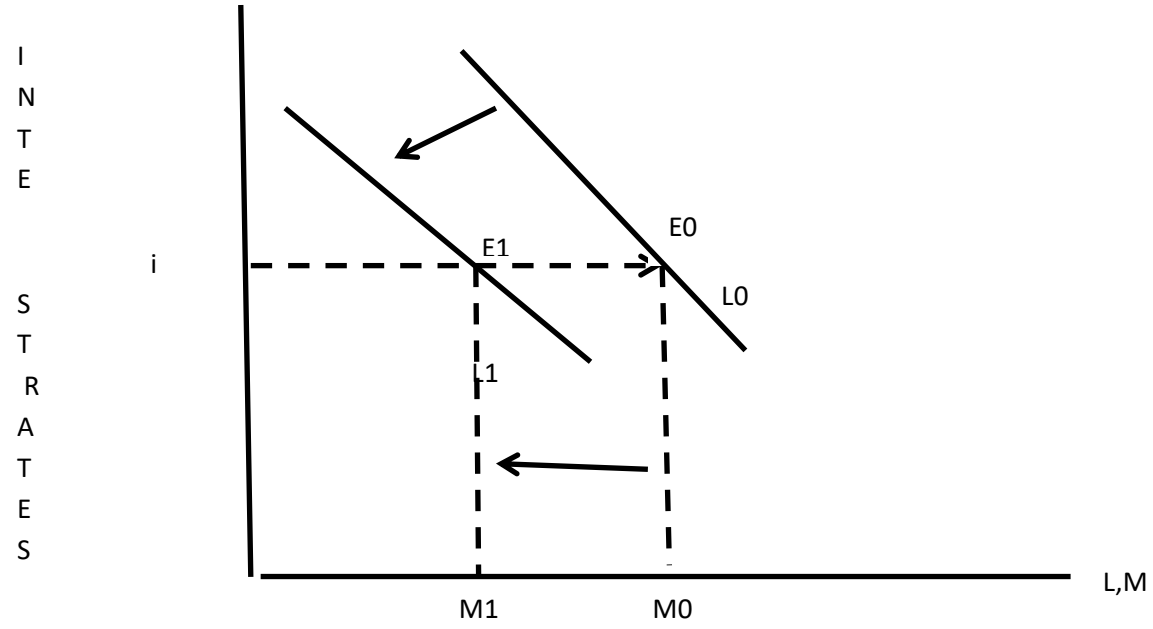
Neutrality
Equity
Administrative simplicity

iii. What are the two main sub-accounts of the balance of payments

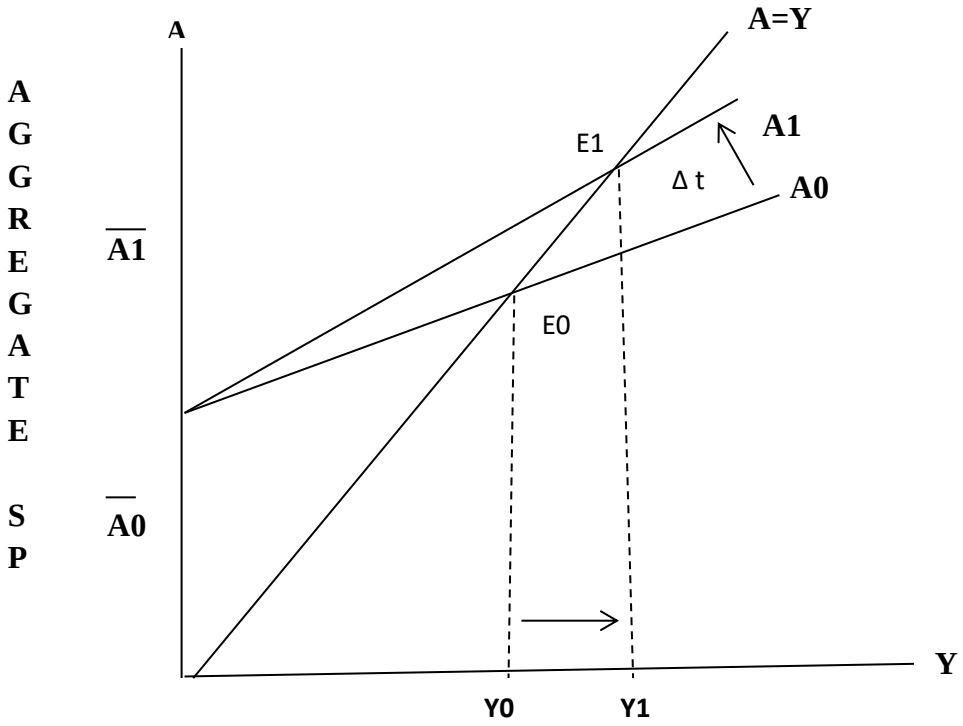
Current account
Financial account

Question2

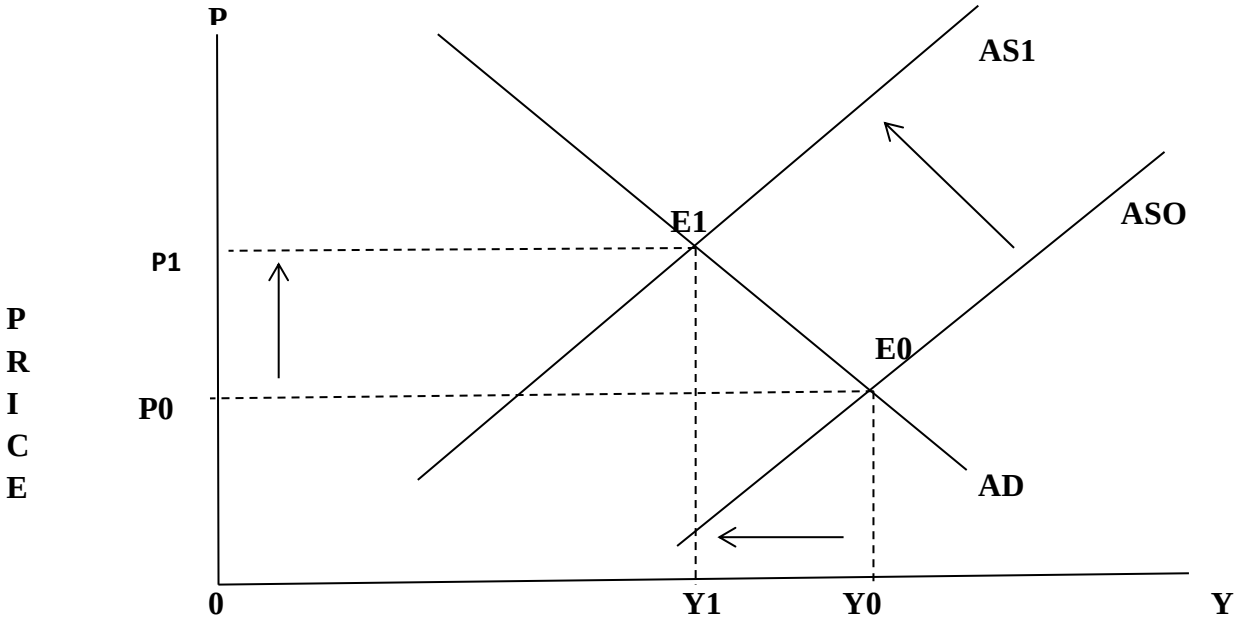
(i) Use the following diagram to show how the equilibrium in the money market changes if the level of income in the economy decreases. Remember to label your graph. (3)



Use the following diagram to illustrate the effect of decrease in he proportional income tax level; of income in a simple Keynesian model of a closed economy. Remember to draw your diagram (3)



(ii) Use the following diagram to illustrate the effect of a <u>decrease</u> in productivity on prices and production in the AD-S model. Remember to label your diagram. (3)



QUESTION 3

(i) Gabriel's disposable income increases from R2000 to 250. As a result his savings increases from 300 to R450. Calculate his marginal propensity to consume. (Show your calculations) (3)

$$\frac{\Delta s}{\Delta Y}$$

$$\frac{450 - 300}{2500 - 2000}$$

$$\frac{150}{500}$$

MPS = 0.30 therefore MPC = 0.70

QUESTION 3

ii) Given the following information:

C = $100 + 8/9Y_d$
$\bar{\imath}$ = 200
$\bar{G}$ = 150
t = ¼
X = 200
Z = 150 + 1/6Y

Calculate (show all your calculations):

- **The size of the multiplier (2)**

Solution

$$= \frac{1}{1 - c\,(1 - t) + m}$$

$$= \frac{1}{1 - 0{,}8\,(1 - 0{,}25) + 0{,}16}$$

$$= \frac{1}{1 - 0{,}8\,(0{,}75) + 0{,}16}$$

$$= \frac{1}{1 - 0{,}5}$$

$$= \frac{1}{0{,}5}$$

$$= \underline{2}$$

Calculate (show all your calculations):

- **The equilibrium level of income. (3)**

Solution

Yo = α ($\bar{A}$)

Yo = 2 (100 + 200 + 150 + 50)

= 2 (500)

= 1 000

- **The value of induced imports at the equilibrium level of income (2)**

Solution

2 = 150 + 1/6 Y

= 1/6 (1 000)

m = 167

QUESTION 4

i) Explain the effect of a strong South African rand on the demand for fruit pickers in the Western Cape. (4)

Solution

Rand	Export (Price $)	Import (R)	CA	Domestic Price
↑	↑	↓	↓	↓

If there is a strong rand then it means that the rand will appreciate against foreign currencies. Since South Africa exports fruit and other agricultural products this will make increase the South African exports prices. The result is that the fruit prices will become more relatively more expensive than the foreign competitors. This means that the demand for South African exported fruit will decrease and the fruit pickers will lose their jobs.

ii) The table below shows the GDP at current prices of country A for the years 1 and 2.

Year	GDP at current prices
1	100
2	110

Given the information in the table, explain why it is impossible to tell whether the 10% increase in GDP from year 1 to year 2 represents economic growth. (3)

Solution

An increase in current (nominal) GDP from one year to another does not necessarily mean that economic growth has taken place the change in GDP could be attributed to prices (inflation) ∴ we need to cater for price changes thus converting current to constant.

iii) Explain the effect of a decrease in the marginal propensity to import on the size of the multiplier. (3)

Solution

A decrease in m will increase the size of the multiplier. As the m creases so does the leakage of income from the economy thus an increase the multiplier.

iv) Explain the impact of an <u>increase</u> in the tax rate on the equilibrium level of income in a Keynesian model of an economy. (4)

Solution

Increase in the income tax will increase the leakage of income in the economy, thus this will decrease the level of output / income in the economy.

v) Define monetary policy and explain how it can be used to combat demand-pull inflation. (8)

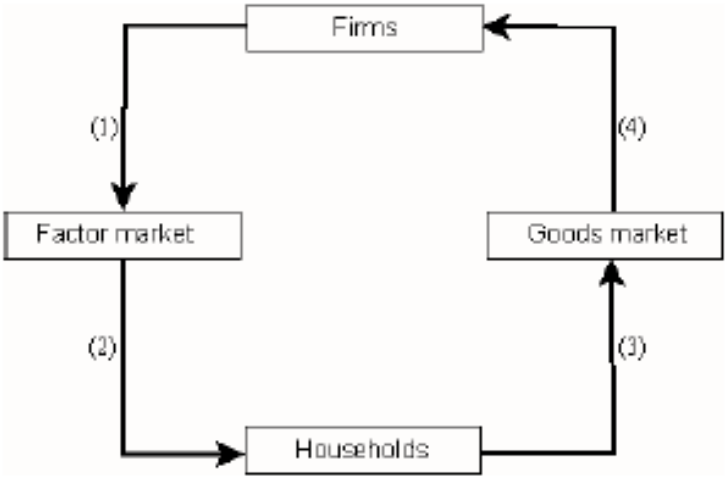
Solution

Monetary policies measures taken by monetary authorities to influence the quantities of money or the interest rates, with the vein at achieving stable prices, full employment and economic growth. (SARB in SA), MPC.

Demand Pull-Inflation occurs when aggregate demand increases. To combat this, authorities have to keep the aggregate demand for goods and service in check. This can be done by applying a restrictive monetary policy. Restrictive monetary policy entails raising interest rates and limits in the increase in MS.

SECTION B

1. The diagram below shows the circular flow of income and spending between households and firms.



Which one of the following statements is correct?

[1] Flows (2) and (3) represent income.
[2] Flows (2) and (4) represent spending.
[3] Flows (1) and (2) represent spending.
[4] Flows (1) and (3) represent spending.

2. Capital formation means

[1] the addition to the quantity of money.
[2] investment.
[3] depreciation.
[4] the addition to stocks, bonds and money.

3. The amount of money that an individual wishes to hold is determined by

[1] the price level and the interest rate.
[2] the price level and real income.
[3] real income.
[4] real income and the interest rate.

4. The quantity of money demanded for precautionary purposes decreases if

[1] total output decreases.
[2] consumer incomes increase.
[3] the interest rate increases.
[4] the inflation rate increases.

5. As the interest rate _____, the opportunity cost of holding money _____ and individuals choose to hold _____ money.

[1] increases; increases; more
[2] decreases; decreases; more
[3] increases; decreases; less
[4] decreases; increases; more

6. An rightward shift in the demand for money curve will lead to

[1] a lower interest rate and the same quantity of money.
[2] a higher interest rate and the same quantity of money.
[3] a higher quantity of money but lower interest rates.
[4] a higher quantity of money but the same interest rate.

7. If the Reserve Bank wants to pursue a contractionary monetary policy, the bank should

[1] raise interest rates and sell securities.
[2] lower interest rates and sell securities.
[3] raise interest rates and buy securities.
[4] lower interest rates and buy securities.

8. _____ is NOT a primary cause of government failure.

[1] The rent-seeking behaviour of interest groups
[2] The inefficient behaviour of the market
[3] The behaviour of bureaucrats
[4] The behaviour of vote-maximising politicians

9. Arguments in favour of privitisation include:

[1] Unlike state-owned firms, privately owned firms will take a broader view of public interest.
[2] Privately owned firms take account of any externalities of production.
[3] Privatised firms are always more efficient than state-owned firms.
[4] Privatised firms will have greater access to investment capital.

10. If government spending is higher than current government revenue, this is known as

[1] a balance of payments deficit.
[2] a budget deficit.
[3] a budget surplus.
[4] the national debt.

11. Which of the following is true about the difference between legal incidence and effective incidence of a tax?

[1] Legal incidence relates to the person who is expected to handover the tax to government whilst effective incidence concerns the person who ultimately bears the burden of paying the tax.
[2] Legal incidence is the individual who ultimately bears the tax burden whilst effective incidence relates to the individual who is expected to hand over the tax to the government.
[3] Legal incidence is when the tax burden is shifted forward to consumers whilst effective incidence occurs when the tax is shifted backwards to employees.
[4] Legal and effective tax incidence basically mean the same thing and therefore can be used interchangeably.

12. If the supply curve of petrol has its normal shape and the price elasticity of demand for petrol is relatively inelastic, then a specific tax of R5 placed on each litre of petrol will be borne

[1] entirely by consumers.
[2] entirely by producers.
[3] more by consumers than by producers.
[4] more by producers than by consumers.

Question 13 is based on the following table showing the gold and diamond production of Zimbabwe and Botswana.

	Botswana	Zimbabwe
Gold (ounces per labour hour)	3	2
Diamonds (carats per labour hour)	9	4

13. Which one of the following statements is correct?

[1] Botswana will not trade as it is more efficient in both products than Zimbabwe.
[2] Botswana will produce diamonds and Zimbabwe will produce gold.
[3] Zimbabwe has a comparative advantage in diamonds production whilst Botswana has a comparative advantage in gold production.
[4] Botswana has a comparative advantage in the production of gold and diamonds.

14. In practice, _____ is the balancing item in the balance of payments.

[1] the balance on the financial account
[2] the change in gold and other foreign reserves
[3] the balance on the current account
[4] unrecorded transactions

15. An increase in the rand price of a foreign currency usually

[1] benefits South African importers.
[2] benefits South African exporters.
[3] benefits both importers and exporter in South Africa.
[4] harmful to both importers and exporter in South Africa.

16. When the rand depreciates against the dollar

[1] export prices increase and import prices decrease.
[2] export prices decrease and import prices increase.
[3] export and import prices increase.
[4] export and import prices decrease.

17. Which of the following figures shows the impact of a decrease in USA interest rates on the South African foreign exchange market?

Figure 1

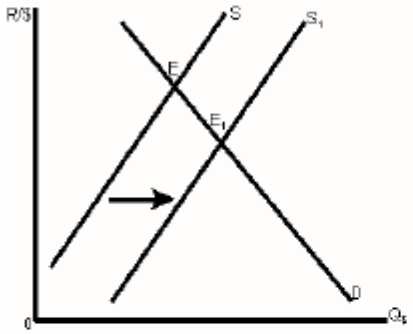


Figure 2

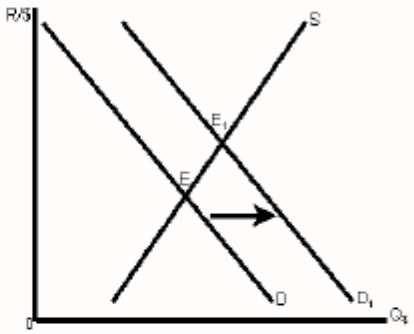


Figure 3

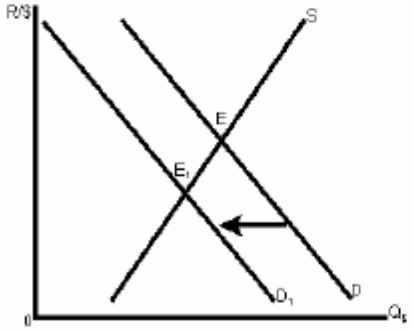
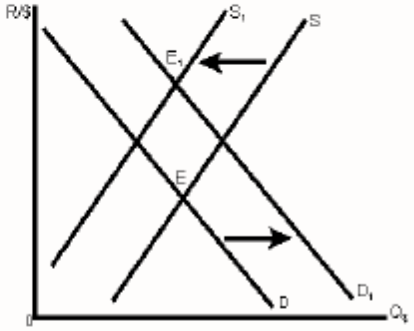


Figure 4



[1] Figure 1
[2] Figure 2
[3] Figure 3
[4] Figure 4

18. The terms of trade indicates the ratio of

[1] exports to imports.
[2] imports to exports.
[3] domestic exchange rates to foreign exchange rates.
[4] export prices to import prices.

19. Double counting

[1] occurs as a result of the double entry bookkeeping systems.
[2] occurs when the value of output is calculated more than once.
[3] is a weakness of the value added method of calculating GDP.
[4] leads to an underestimation of the GDP.

Question 20 is based on the following information.

Year	CPI
2000	100
2002	125
2004	135

20. Consumer prices

[1] rose by 10% from 2002 to 2004.
[2] fell by 25% from 2000 to 2002.
[3] fell by 10% from 2002 to 2004.
[4] rose by 8% from 2002 to 2004.

21. In a country with a population of 70 million people, there are 20 million children under the age of 15 years, 35 million employed, 9 million pensioners, 5 million unemployed and 1 million full-time students. The unemployment rate in this county equals

[1] 7,1%
[2] 12,5%
[3] 25%
[4] 30%

22. In the Keynesian model, GDP is determined by the

[1] level of taxes.
[2] price level.
[3] level of aggregate demand.
[4] level of aggregate supply.

23. The equilibrium level of income is that at which

[1] the budget is balanced.
[2] the balance of payments is in equilibrium.
[3] the economy is at full employment level of income.
[4] there is no tendency for national income to change.

24. When aggregate planned expenditure is less than GDP, there is an unintended _____ in inventories, firms _____ production, and GDP begins to _____.

[1]	decrease	increase	increase
[2]	increase	decrease	decrease
[3]	increase	decrease	increase
[4]	decrease	increase	decrease

25. Given the following information: $\bar{C}$ = 60, c = 0.75, Y = 3000, and T = 800. The value of private consumption expenditure is

[1] 1590.
[2] 1510.
[3] 1710.
[4] 2245.

26. In the simple Keynesian model of a closed economy with a government,

[1] government spending is greatly influenced by changes in income.
[2] an increase in government spending causes the slope of the aggregate spending curve to increase.
[3] an increase in government spending leads to an increase in the marginal propensity to consume.
[4] an increase in government spending would increase autonomous spending by that same amount.

27. In a simple Keynesian model with government and foreign sectors, which one of the following statements is **incorrect**?

[1] The change in the level of exports is dependent on exchange rates, among other factors.
[2] The change in the level of imports is dependent on the level of domestic income.
[3] An increase in the marginal propensity to import would increase imports.
[4] The multiplier has bigger impact on income when it is assumed that imports are dependent on income.

28. A decrease in leakages from the Keynesian model of an open economy with a government leads to _____ in the multiplier.

[1] a decrease
[2] no change
[3] an increase

29. As income rises following an increase in autonomous net exports, tax revenue will _____ and induced imports will _____.

[1] fall; fall
[2] fall; rise
[3] rise; fall
[4] rise; rise

30. A simultaneous increase in wages and an increase in taxes increase will

[1] definitely be inflationary.
[2] result in a leftward movement of the AD-curve and a downward movement along the AS-curve.
[3] result in a leftward movement of the AS-curve and a downward movement along the AD curve.
[4] have an uncertain affect on the price level but will decrease the output.

31. If the aggregate supply curve is perfectly inelastic, an increase in aggregate demand will lead to an increase in

[1] the price level.
[2] the price level and real national output.
[3] the price level and employment.
[4] real national output and employment.

32. Suppose the SARB decrease interest rates while the oil price is increasing. What would be the expected effect on real GDP and the price level?

	Price level	Real GDP
[1]	uncertain	decreases
[2]	increases	uncertain
[3]	decreases	decreases
[4]	increases	decreases

33. Which one of the following statements regarding the monetary transmission mechanism is correct?

[1] The monetary transmission mechanism is more effective when initiated by a change in the tax rate.
[2] The Reserve Bank does not depend on an effective monetary transmission mechanism when applying contractionary monetary policy.
[3] The monetary transmission mechanism illustrates how changes in the monetary sector affect the real sector.
[4] The smaller the interest elasticity of investment demand and the steeper the AS curve the more effective expansionary monetary policy will be.

34. If the inflation rate was 10 percent last year and is now 6 percent for this year, it means

[1] prices are falling.
[2] prices are falling at a slower rate.
[3] prices are increasing at a slower rate.

35. Bracket creep would be eliminated when tax rates are based on

[1] nominal income.
[2] real income.
[3] per capita income.
[4] nominal disposable income.

36. Which one of the following statements on unemployment is correct?

[1] The desire to find employment is good enough to be classified as unemployed according to the strict definition of unemployment.
[2] Stricter immigration control can be regarded as a policy strategy to reduce unemployment.
[3] The economic active population plus the unemployed is equal to the total population.
[4] Economic growth cannot be achieved without a decrease in the level of unemployment.

37. If the expected inflation rate is 5% and negotiators agree that real wages should rise by 7%, the two sides will agree to an increase in the money wage of

[1] 2%.
[2] 5%.
[3] 7%.
[4] 12%.

38. The Phillips curve shows a negative relationship between

[1] the unemployment rate and employment.
[2] employment and prices.
[3] the unemployment rate and the inflation rate.
[4] employment and the inflation rate.

39. A nation's standard of living will certainly increase when

[1] real GDP rises faster than population.
[2] real GDP rises faster than the price level.
[3] real GDP rises.
[4] real GDP rises faster than the number of people employed.

40. Assume a given government spending and tax rate. The budget deficit will grow during _____ and decline during _____.

[1]	booms	booms
[2]	recessions	recessions
[3]	booms	recessions
[4]	recessions	booms

Solutions to MCQ

1) 4	**2) 2**	**3) 2**	**4) 1**	**5) 2**
6) 4	**7) 1**	**8) 2**	**9) 3**	**10) 2**
11) 1	**12) 3**	**13) 1**	**14) 2**	**15) 2**
16) 2	**17) 1**	**18) 4**	**19) 2**	**20) 4**
21) 2	**22) 3**	**23) 4**	**24) 2**	**25) 3**
26) 4	**27) 4**	**28) 2**	**29) 4**	**30) 4**
31) 1	**32) 2**	**33) 3**	**34) 3**	**35) 2**
36) 2	**37) 4**	**38) 3**	**39) 1**	**40) 4**