UNIVERSITY OF FORT HARE
ALICE AND EAST LONDON CAMPUSES

Economics Foundation
ECO 123F/ECO 123L

MAIN EXAMINATION

OCTOBER/NOVEMBER 2018

Time: 3 Hours

Subject: ECO 123F/ECO 123L

Marks: 100

This paper consists of 9 pages, including the cover page

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INSTRUCTIONS
Section A is COMPULSORY. Choose four questions from section B.

Graphs, where applicable, must be clear and well labelled.

Marks will be awarded for relevant examples.
SECTION A (COMPULSORY)
MULTIPLE CHOICE QUESTIONS

1. An increase in the market interest rates:
   A. will shift the money demand curve downwards.
   B. implies a lower opportunity cost of holding money balances.
   C. will cause the price of bonds to fall.
   D. will increase the purchasing power of money.

2. A decrease in the rate of interest:
   A. lowers the opportunity cost of money and leads to an increase in the quantity
      of money demanded
   B. raises the opportunity cost of money and leads to an increase in the quantity of
      money demanded.
   C. lowers the opportunity cost of money and leads to a decrease in the quantity of
      money demanded.
   D. raises the opportunity cost of money and leads to a decrease in the quantity of
      money demanded.
   E. does not affect the quantity of money demanded

3. Which of the following will cause the demand curve for money to shift to the right?
   A. An increase in real GDP.
   B. A decrease in the repo rate.
   C. An increase in the quantity of money available.
   D. A decrease in the quantity of money available.
   E. An increase in the price level

4. Which one of the following is not a function of the South African Reserve Bank?
   A. To formulate and implement monetary policy.
   B. To maintain financial stability.
   C. To finance government expenditure.
   D. To provide economic and statistical services.
   E. To act as banker to other banks.
5. Which one of the following statements is correct?
   A. The money market is one of the most important markets in the real sector of the economy.
   B. Monetarists believe that an increase in money supply will increase output in the long run.
   C. An increase in money supply is one of the main instruments of fiscal policy.
   D. Monetarists would recommend that money supply should be increased at approximately the same rate as real production.

6. According to supply-side theorists, the aggregate supply curve will shift to the right when:
   A. the quantity of money increases.
   B. marginal tax rates rise.
   C. government spending on on-the-job training increases.
   D. unemployment benefits are increased.
   E. the government’s education budget is cut.

7. The policy recommendations of supply-side economists include that:
   A. government needs to increase the quantity of money to bring about full employment.
   B. the supply of goods and services produced by the government needs to be increased.
   C. the government should introduce specific regulations to see that the correct type of investment is undertaken.
   D. government should reduce its spending and general involvement in the economy.
   E. taxes should be increased to provide for a greater supply of government services to the poor.
Consider the following diagram and answer Questions 8 and 9.

8. The immediate effect of a decrease in government expenditure will be to:
   A. move the AD curve to the left.
   B. move the AD curve to the right.
   C. move the AS curve to the left.
   D. move the AS curve to the right.
   E. leave the curves unchanged.

9. If South Africa were to discover a plentiful supply of cheap oil, this would:
   A. move the AD curve to the left.
   B. move the AD curve to the right.
   C. move the AS curve to the left.
   D. move the AS curve to the right.
E. have no effect on the curves.

10. Stagflation refers to a situation where:
   A. economic growth is experienced and leads to an increase in the inflation rate.
   B. high inflation rates and high employment rates are experienced simultaneously.
   C. high inflation rates and high unemployment rates are experienced simultaneously.
   D. a period of high inflation is followed by a period of stagnation in the economic growth rate.

11. Which one of the following statements is NOT true?
   A. Money is a unit of account.
   B. Money is a store of value.
   C. Money is a medium of exchange.
   D. Money is another term for income.
   E. Money is the most liquid asset.

12. Which of the following best describes the M1 measure of the money stock?
   A. It is the M3 money measure minus the M2 money measure.
   B. M1 includes cash and medium term deposits.
   C. M1 is cash plus demand deposits.
   D. M1 is cash minus demand deposits.
   E. M1 is the most comprehensive measure of money stock available.

13. Which of the following is true of the money market?
   A. The speculative demand for money is a function of the interest rate.
   B. The liquidity preference curve slopes upward.
   C. The transactions demand for money is a function of the interest rate.
   D. The precautionary demand for money is a function of the interest rate.
   E. Higher rates of interest lead to a higher demand for liquidity.

14. Which of the following would be classed as an expansionary monetary policy?
   A. A decrease in the quantity of money.
   B. A decrease in interest rates.
   C. An increase in government taxation.
   D. An increase in government expenditure.
   E. An increase in VAT.
15. Which one of the following is incorrect?

Money serves as:

A. a means of payment.
B. a medium of exchange.
C. a factor of production.
D. a unit of account.
E. a store of value.

16. Which one of the following statements is correct?

A. In a monetary economy there always has to be a double coincidence of wants.
B. Money can never lose its usefulness as a unit of account.
C. Money is always the best possible store of value.
D. The stock of money consists largely of notes and coins.
E. Money is not the only possible store of value.

17. Which one of the following statements is incorrect?

A. In a barter economy there has to be a double coincidence of wants before exchange can take place.
B. Money is not the only possible unit of account in a monetary economy.
C. Money is a good store of value during periods of high inflation.
D. Money always serves as a medium of exchange.
E. Modern money is not covered by a commodity such as gold.

18. When the inflation rate is expected to exceed the target rate by a significant margin, the SARB will tend to:

A. reduce the cost of credit to the banks.
B. increase the repurchase rate (repo rate).
C. purchase government bonds on the open market.
D. decrease the repurchase rate (repo rate).
E. use moral suasion to persuade banks to provide more loans to their clients.

19. Interest rates in South Africa are essentially determined by:

A. the cost of capital.
B. the interaction between the demand for money and the supply of money.
C. the South African Reserve Bank.
D. the South African government.
E. the quantity of money in circulation.
20. The repo rate is:
   A. the rate at which the SARB advances loans to the government.
   B. the best interest rate an investor can obtain on a long-term deposit.
   C. the rate at which banks provide loans to their best customers.
   D. the rate at which the SARB provides loans to other banks.
   E. the rate at which the quantity of money demanded is equal to the quantity of money supplied.

[20 MARKS]

SECTION B (CHOOSE ONLY FOUR QUESTIONS)
EACH QUESTION CARRIES 20 MARKS

Question Two
1. Use the AD-AS model to illustrate and explain how the authorities can use monetary and fiscal policies to stimulate the economy. What side-effects would such policies have? What is the significance of the slope/condition of the AS curve in this regard?

[14 Marks]

2. Describe the three motives for holding money

[6 Marks]

[20 MARKS]

Question Three
1. Use the AD-AS model to illustrate and explain the stagflation phenomenon. Can stagflation be combated by expansionary monetary or fiscal policies? Explain

[12 Marks]

2. Describe the various lags associated with monetary and fiscal policy

[8 Marks]

[20 MARKS]
Question Four

1. The following table illustrates the number of pants and shirts which can be produced by one worker per day in South Africa and Zimbabwe.

<table>
<thead>
<tr>
<th>Countries</th>
<th>Pants</th>
<th>Shirts</th>
</tr>
</thead>
<tbody>
<tr>
<td>South Africa</td>
<td>20 per worker, per day</td>
<td>10 per worker, per day</td>
</tr>
<tr>
<td>Zimbabwe</td>
<td>30 per worker, per day</td>
<td>45 per worker, per day</td>
</tr>
</tbody>
</table>

(a) Which country has the Absolute Advantage in the production of both goods? [1 Mark]

(b) In terms of Absolute Advantage, is the basis for trade possible between the two countries? Explain [2 Marks]

(c) Which country has a Comparative Advantage in the production of pants? Explain why. [3 Marks]

(d) Which country has a Comparative Advantage in the production of shirts? Explain why. [3 Marks]

2. Explain how an increase in value of South African Rand against the United States Dollar can influence exports and imports. [4 Marks]

3. Who would benefit and who would lose if the South African government doubled the tariff on imported frozen chicken leg quarters from Brazil? Explain [5 Marks]

4. If you expect that interest rates are going to fall, will you hold cash or buy bonds? Explain your answer. [2 Marks]

[20 MARKS]

Question Five

1. Can monetary and fiscal policy be used to counteract (or combat) demand-pull inflation? Use a diagram (or diagrams) to explain your answer. [12 Marks]

2. What type of unemployment does each of the following represent? Explain your answers. [8 Marks]

(a) Workers at a clothing factory in Newcastle lose their jobs when the firm relocates to Lesotho.
(b) Workers at a factory making cassette tapes lose their jobs when the firm goes under due to competition from compact discs.

(c) Migrant farm workers’ employment is terminated when the harvest is finished.

(d) Workers at the BMW plant in Rosslyn are laid off as a result of a slump in motorcar sales.

[20 MARKS]

Question Six

1. Use diagrams to explain the difference between demand-pull inflation and cost-push inflation. [12 Marks]

2. What is the essential difference between the classical and Keynesian views on the causes of business cycles? [5 Marks]

3. Define the business cycle and list the different stages of a full cycle. [3 Marks]

[20 MARKS]