

UNIVERSITY OF FORT HARE  
ALICE AND EAST LONDON CAMPUS

ECO221

BACHELOR OF COMMERCE  
JANUARY 2019  
SUPPLEMENTARY EXAMINATION

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Time: 3 Hours

Subject: Macroeconomics

Marks: 100

This paper consists of 9 pages including the cover page

Internal Examiners

Mr Wilson C

Ms Mayekiso S

Mr Mjacu L

Instructions

1. Answer ALL questions in Section A. Section A is compulsory.
2. Answer only three questions in section B, all questions carry equal marks.
3. Section A is to be answered on the answer grid provided.
4. Answer Section B in the answer book.
5. The multiple choice answer sheets are to be placed inside the examination book on completion of the examination.

## SECTION A

### ANSWER ALL QUESTIONS FROM THIS SECTION

1. In the Keynesian view:
  - a) both monetary and fiscal policy can affect income.
  - b) monetary policy can be ineffective when money demand is less interest rate elastic.
  - c) fiscal policy is a more reliable way to stimulate output during a recession.
  - d) all of the above.
  
2. According to the quantity theory, inflation is ultimately controlled by:
  - a) private firms who set prices.
  - b) the monetary authorities who control the money supply.
  - c) those who control output.
  - d) the price of oil.
  
3. Which of the following statements is (are) correct? The equilibrium interest rate is the rate that:
  - a) equates the supply of loanable funds with the demand for loanable funds
  - b) equates new saving with investment plus the bond-financed government surplus
  - c) equates private savings with investment
  - d) All of the above
  
4. Supply-side economists
  - a) focus almost exclusively on the supply-side effects of changes in the money supply.
  - b) did not devote much attention to the supply-side effects of changes in income tax rates since the marginal income tax rate is very low and pertained only to the relatively wealthy.
  - c) argued that cuts in marginal tax rates had very favourable supply-side effects.
  - d) argue that government spending is at least as important as tax rates
  
5. The Cambridge Cash-Balance Model is expressed as follows:
  - a) a.  $M_s = kPY$
  - b) b.  $MV_y = PY$
  - c) c.  $V_y = PY$
  - d) d.  $M_d = Kpy$
  
6. Diminishing marginal returns refers to the fact that:
  - a) holding other inputs constant, additional increases in labour lead to smaller changes in output.
  - b) holding other inputs constant, additional increases in labour lead to lower output.
  - c) additional increases in labour always lead to smaller changes in output
  - d) the returns to labour fall as real wages rise.

7. An open-economy model is one that:
- a) allows for trade among nations.
  - b) permits free flow of individuals among nations.
  - c) encourages imports but not exports.
  - d) advocates more exports than imports.
  - e) Both a and b.
8. Which of the following indices best signals future movements in retail prices?
- a) The implicit GDP deflator
  - b) nominal GDP
  - c) The consumer price index
  - d) The producer price index
  - e) The measure of economic welfare (MEW)
9. If real GDP exceeds potential GDP, this means that:
- a) output is below the level produced at the benchmark rate for high employment and high rate of resource utilization.
  - b) this cannot occur; the economy can never be at a point where real GDP exceeds potential GDP.
  - c) cyclical output is above what the economy can sustain in the long-run.
  - d) the economy is expanding.
10. Under perfect capital mobility and a floating exchange rate system, expansionary fiscal policy leads to:
- a) an increase in income and the interest rate.
  - b) no change in the interest rate and a fall in the trade balance.
  - c) no change in the interest rate and a decrease in income.
  - d) an increase in interest rates and a fall in the trade balance.
  - e) no change in interest rates and the exchange rate.
11. In the equilibrium version of the classical model, the velocity of money:
- a) depends on the real rate of interest.
  - b) depends on the level of employment.
  - c) is equal to the Cambridge  $k$ .
  - d) is stable in the short run.
12. In the closed economy IS-LM model, an increase in government spending crowds-out:
- a) prices.
  - b) the money supply.
  - c) consumption.
  - d) investment.
  - e) both c and d.

13. The classical economists believed that:

- a) labour supply is upward sloping because the income effect is greater than the substitution effect.
- b) labour supply is upward sloping because the substitution effect is greater than the income effect.
- c) labour supply is downward sloping because the income effect is greater than the substitution effect.
- d) in equilibrium, the marginal product of labour must exceed the real wage.
- e) both b and d.

14. The classical economists attacked the mercantilist propositions that:

- a) state action was necessary to direct the capitalist system.
- b) money had no intrinsic value.
- c) output was completely supply-determined.
- d) the wealth of a nation was closely linked to the country's stock of precious metals.
- e) Both a and d

15. In the base year, the relationship between nominal and real GDP is:

- a) uncertain.
- b) one of equality.
- c) real GDP is higher.
- d) nominal GDP is higher.

16. The BP schedule will be upward-sloping in the case of:

- a) perfect capital mobility.
- b) imperfect capital mobility.
- c) fixed exchange rate.
- d) flexible exchange rate.

17. In the classical macroeconomic model, a decrease in the real wage would cause:

- a) A decrease in the marginal product of labour and an increase in the quantity demanded for labour.
- b) an increase in the marginal product of labour and an increase in the quantity demanded for labour.
- c) no change in the quantity demanded for labour.
- d) an increase in both the supply of and demand for labour.

18. In the long run, according to Monetarists:

- a) the natural rates of output and employment depend on factor supplies.
- b) the natural rates of output and employment depend on technology.
- c) the influence of the money stock is mainly on the price level and other nominal variables.
- d) All of the above.

19. Which of the following statements is correct?
- The classical aggregate supply schedule is horizontal while the Keynesian aggregate supply schedule slopes upward to the left.
  - The classical aggregate supply schedule is vertical while the Keynesian aggregate supply schedule is horizontal.
  - The classical aggregate supply schedule is vertical while the Keynesian aggregate supply schedule slopes upward to the right.
  - The classical aggregate supply schedule slopes upward to the right while the Keynesian aggregate supply schedule is vertical.
20. The net capital inflow is:
- positively related to the domestic interest rate minus the foreign interest rate.
  - negatively related to the domestic interest rate minus the foreign interest rate.
  - positively related to the exchange rate.
  - negatively related to the exchange rate.
  - both a and c.
21. Which of the following statements is (are) correct? The Mundell-Fleming model is:
- an open-economy version of the IS-LM model.
  - implicitly assumes a fixed domestic price level.
  - a new closed-economy model.
  - both a and b.
22. The Keynesian model:
- assumes a stable, downward sloping Phillips curve in the short run.
  - implies a horizontal Phillips curve in the long run.
  - shows that the Phillips curve can be downward or upward sloping in the short run.
  - differs from Friedman's analysis pertaining to the vertical long-run Phillips curve.
23. The lower the interest elasticity of money demand:
- The steeper the LM curve.
  - The flatter the LM curve.
  - The steeper the IS curve.
  - The flatter the IS curve.
  - Both the LM and IS curve will be steeper.
24. The Keynesian aggregate demand curve slopes downward because for any given money supply, an increase in the price level \_\_\_\_\_ real money holdings which \_\_\_\_\_ the interest rate and \_\_\_\_\_ income.
- increases; lowers; increases
  - reduces; raises; reduces
  - reduces; lowers; increases
  - increases; raises; reduces

25. Friedman and Phelps concluded that:

- a) inflation and unemployment are unrelated in the long-run.
- b) inflation and unemployment are unrelated in the short-run.
- c) Philips curve shows the short-run relationship between inflation and unemployment.
- d) fiscal policy could be effective in the short run but not in the long run.

## SECTION B

ANSWER ANY THREE QUESTIONS [All questions carry equal Marks]

### QUESTION 2

- a. Graphically show and analyse the effects of an increase in taxes on the IS-LM model [13]
- b. Illustrate and explain the relationship between the slope of the LM curve and the effectiveness of an expansionary fiscal policy. [12]

### QUESTION 3

- a. Illustrate and explain what factors cause the LM curve to shift [13]
- b. What are three sources of wage rigidity that Keynes identified? [12]

### QUESTION 4

- a. Compare and contrast the Cambridge and Fisher versions of the quantity theory. Explain why the Cambridge version of the quantity theory represents a more modern monetary theory when compared to Fisher's version. [13]
- b. Keynes considered three motives for holding money. Which of these was similar to the classical quantity theory of money demand? Which one is unique to Keynesian theory [12]

### QUESTION 5

- a. Using the Mundell-Fleming model, illustrate and explain the effect of an expansionary monetary policy by the South African Reserve Bank under imperfect capital mobility and a flexible exchange rate regime. [13]
- b. Illustrate and explain the effect of an expansionary fiscal policy with a flexible exchange rate on the balance of payments when the BP schedule is flatter. [12]

### QUESTION 6

- a. With the aid of correct and clear diagram, explain how interest rates are determined in the Classical system [13]
- b. i) Define the term velocity of money [2]
- ii) Calculate the velocity of money according to Irving Fisher, if in 2010 the value of transactions were R7 200 billion and the money supply were R600 billion. [2]

- c. An economy produces three goods: Laptops, Equipment and cabbages. Quantities and prices per unit for years 2016 and 2017 are as follows:

	2016		2017	
	Quantity	Price	Quantity	Price
<b>Laptops</b>	10	R2000	12	R3000
<b>Equipment</b>	4	R1000	6	R500
<b>Cabbages</b>	1000	R5	1000	R5

- i) Use the prices from 2016 as the set of common prices to calculate real GDP in 2016 and in 2017. [3]
- ii) Calculate the GDP deflator for 2016 and 2017, and calculate the rate of inflation from 2016 to 2017. [4]
- iii) When is Nominal GDP the same as Real GDP [1]

**END OF EXAMINATION PAPER**