

**UNIVERSITY OF FORT HARE
ALICE AND EAST LONDON CAMPUSES**

**Economics Foundation
ECO 123F/ECO 123L**

SUPPLEMENTARY EXAMINATION

JANUARY 2019

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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 three 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

Question One

1. Money overcomes the problem of a double coincidence of wants inherent in the barter system through its function as a:
 - A. medium of exchange.
 - B. unit of account.
 - C. standard of deferred payment.
 - D. store of value.
 - E. financial intermediary.
2. The _____ demand for money arises out of the need to hold money as a medium of exchange. This demand for money is a function of _____.
 - A. precautionary; interest rates
 - B. transactions; national income
 - C. speculative; interest rates
 - D. precautionary; national income
 - E. transactions; interest rates
3. 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.
4. 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.

5. 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.
6. 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.
7. 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.
8. Which one of the following statements is **incorrect**?
- A. As interest rates increase, bond prices decrease.
 - B. As interest rates decrease, bond prices increase.
 - C. There is a positive relationship between interest rates and bond prices.
 - D. If interest rates are high, the quantity of money demanded will tend to be low.
 - E. If interest rates are low, the quantity of money demanded will tend to be high.
9. Which one of the following statements is **incorrect**?
- A. In South Africa money is created exclusively by the South African Reserve Bank.
 - B. The stock of money consists largely of bank deposits and banks create these deposits by making loans.
 - C. Money creation by banks is constrained by the demand for bank loans.
 - D. The South African Reserve Bank uses changes in interest rates in an attempt to regulate the rate at which new money is created.

- E. The stock (quantity) of money in the economy is essentially determined by the interaction of the interest rate and the demand for money. There is no independent supply of money.
10. 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.
11. 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.
12. 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.
13. Which one of the following statements is **incorrect**?
- A. The aggregate AD-AS model seeks to explain the general price level and the aggregate production of goods and services.
 - B. The aggregate demand curve shows the aggregate quantities that are demanded at different price levels.
 - C. If aggregate supply falls, there will be an upward pressure on prices, *ceteris paribus*.
 - D. In terms of the AD-AS model, if aggregate demand falls, with no change in aggregate supply, unemployment will tend to decrease.

- E. An increase in investment spending will result in a rightward shift of the AD curve.
14. 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.
15. Classical economists who preceded Keynesians believed that:
- A. increases in the quantity of money could alter the level of production in the economy.
 - B. as demand increases, supply increases.
 - C. economies that do not suffer from government interference will reach full employment equilibrium.
 - D. increases in government spending are necessary during times of recession.
16. According to the supply-siders, tax cuts announced by the Minister of Finance:
- A. result in higher saving and work effort, which will lead to greater production in the economy.
 - B. increase inflation in South Africa.
 - C. reduce inflation in South Africa.
 - D. cause both A and C to occur.
17. 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.

18. The policy recommendations of the supply-side economists would differ from those of Keynesians as follows:
- A. Keynesians believe that government expenditure should be increased to bring about full employment, whereas supply-siders believe that government should increase the quantity of money.
 - B. Keynesians believe that government often needs to manipulate aggregate demand, whereas supply-siders believe that it should manipulate aggregate supply by taking over the production of key goods and services.
 - C. Keynesians believe that government should control the level of prices whereas supply-siders do not.
 - D. Keynesians believe that government needs to intervene in the economy to maintain stability, whereas supply-siders do not.
 - E. Keynesians believe that the correct way to stabilise the economy is through the use of fiscal policy whereas supply-siders believe the appropriate instrument is monetary policy.
19. Which of the following features is not consistent with supply-side theory?
- A. Deregulation
 - B. Privatisation
 - C. Reductions in marginal tax rates
 - D. Expansionary fiscal policy
20. Indicate which one of the following statements is **false**
- A. In the AD-AS model prices are regarded as variable.
 - B. In the AD-AS model wages have no impact on the level of output.
 - C. In the AD-AS model the impact of monetary policy on the level of output can be analysed.
 - D. In the AD-AS model the level of economic activity (output) is determined by the interaction of aggregate demand and supply.
21. Which one of the following is not assumed in the AD-AS model?
- A. Prices are variable.
 - B. Wages are variable.
 - C. Aggregate supply can change independently of aggregate demand.
 - D. The quantity of money is fixed.
 - E. Interest rates are variable.

22. Which one of the following statements is **incorrect**?

In the AD-AS model:

- A. the general price level (P) is depicted on the vertical axis.
- B. total production or income (Y) is depicted on the horizontal axis.
- C. the equilibrium levels of P and Y are determined by the interaction of AD and AS.
- D. we deal with the economy as a whole.
- E. the price level is determined by the cost of production, particularly wages.

23. Which one of the following statements is incorrect?.

In the AD-AS model:

- A. there is an inverse relationship between the general price level and the volume of goods and services demanded.
- B. there is a positive relationship between the general price level and the volume of goods and services supplied.
- C. the volume of goods and services demanded decreases as the general price level decreases.
- D. the volume of goods and services supplied increases as the general price level increases.
- E. the AD curve has essentially the same shape as any normal demand curve.

24. Which one of the following is not a component of aggregate demand in the economy?

- A. Consumption spending by households.
- B. Investment spending by firms.
- C. Spending on our exports by foreigners.
- D. The productivity of the factors of production.
- E. Government spending.

25. Which one of the following is not a possible explanation for the slope of the AD curve?

- A. The oil price effect.
- B. The interest rate effect.
- C. The real balance effect.
- D. The wealth effect.
- E. The international trade effect.

[25 MARKS]

SECTION B (CHOOSE ONLY THREE QUESTIONS)

EACH QUESTION CARRIES 25 MARKS

Question Two

1. Draw a demand and supply curve for British pounds (on the vertical axis plot rand per British pound). What factors are likely to cause an increase in the demand for British pounds (in exchange for South African rands)? How can this be illustrated in the diagram you have drawn? Does this represent an appreciation or depreciation of the South African rand relative to the British pound? **[12 Marks]**
2. Use examples to explain the difference between absolute advantage and comparative (or relative) advantage in international trade. **[8 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]**

[25 MARKS]

Question Three

1. Explain how changes in exchange rates can influence exports and imports. **[5 Marks]**
2. Explain using examples, what “the monetary transmission mechanism” means. **[5Marks]**
3. Describe the various lags associated with monetary and fiscal policy and explain why the timing of policy decisions and actions is so important. **[8 Marks]**
4. Briefly explain the difference between Say’s law and Keynes’s views about the relationship between aggregate demand and aggregate supply in the economy. **[7 Marks]**

[25 MARKS]

Question Four

1. Define inflation and discuss the significance of the different elements of the definition. **[5 Marks]**
2. Do you agree with the following statement: “The price of electricity is going up; therefore we are experiencing inflation”? Explain your answer. **[5 Marks]**

3. If all wages increase in line with the inflation rate, would inflation still be a problem? Explain. **[5 Marks]**
4. What are the main possible causes of demand-pull inflation? **[5 Marks]**
5. Explain how the South African Reserve Bank tries to control inflation in South Africa. **[5 Marks]**

[25 MARKS]

Question Five

1. Can monetary and fiscal policy be used to combat cost-push inflation? Explain with the aid of a diagram. **[12 Marks]**
2. How would you explain the notion of a “Phillips curve” to a friend or family member? Use a diagram to explain. **[10 Marks]**
3. Identify the supply factors in economic growth. **[3 Marks]**

[25 MARKS]

