



University of Fort Hare
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UNIVERSITY OF FORT HARE

ALICE AND EAST LONDON

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SUPPLEMENTARY EXAMINATION

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Time: 3 HOURS

Subject: INTRODUCTION TO ECONOMICS

Marks: 100

This paper consists of 14 pages including the cover page

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INSTRUCTIONS

Answer All Questions in Section A
Answer ALL Questions in Section B

SECTION A

ANSWER ALL QUESTIONS IN THIS SECTION

EACH QUESTION IN THIS SECTION CARRIES 1 (ONE) MARK

1. If the government wishes to increase the equilibrium level of income by R100 million, it should:

- A. increase government spending by R100 million.
- B. increase government spending by less than R100 million.
- C. increase government spending by more than R100 million.
- D. increase the tax rate.
- E. decrease government spending by R100 million divided by the multiplier.

2. In a Keynesian model of a closed economy, if total autonomous spending is R1 000 billion, the tax rate is 0,2 (or 20%) and the marginal propensity to consume is 0,625, then the equilibrium level of income is:

- A. R3 333 billion.
- B. R1 250 billion.
- C. R2 000 billion.
- D. R1 600 billion.
- E. impossible to calculate.

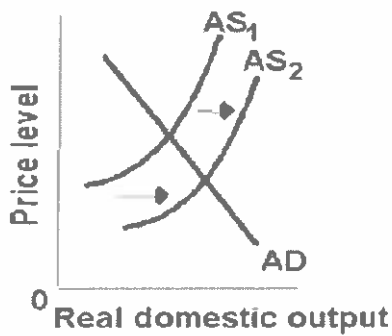
3. What will the repercussions be if there is an increase in the repo rate?

- a. Credit will become cheaper and people will tend to spend more.
- b. There will be growth in the GDP as a result of an increase in the money stock.
- c. There will be an increase in the money stock level, resulting in increased spending.
- d. There will be a decrease in the money supply, and inflation will be shortened.

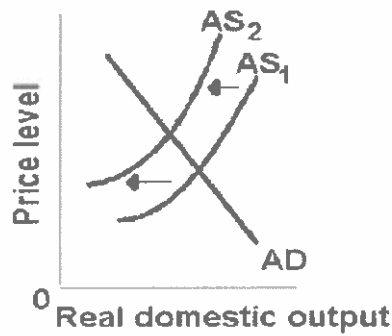
4. Which one of the following statements is correct?

- a. The PPI basket contains goods and services.
- b. The PPI basket excludes capital goods.
- c. The prices used to compile the PPI exclude value-added tax.
- d. The CPI basket includes capital goods.
- e. The CPI basket excludes services.

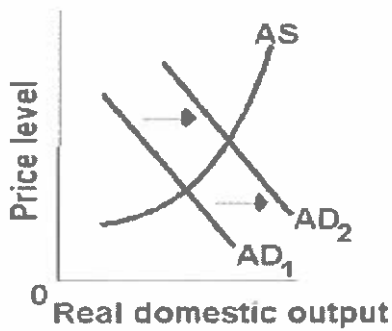
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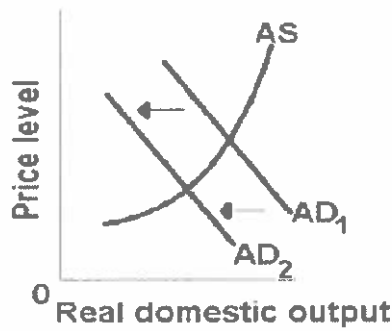
(A)



(B)



(C)



(D)

Which of the above diagrams best depicts the effects of an increase in consumer spending?

- a. A
- b. B
- c. C
- d. D

6. Which one of the following statements about demand-pull inflation is incorrect?

- a. Demand-pull inflation tends to be accompanied by an increase in the level of production and income.
- b. Demand-pull inflation may be illustrated by a rightward shift of the AD curve.
- c. Demand-pull inflation may be caused by a greater availability of consumer credit.
- d. Demand-pull inflation may be caused by the availability of cheaper consumer credit.
- e. Demand-pull inflation tends to be accompanied by higher unemployment.

7. Which one of the following is **not** a possible cause of cost-push inflation?

- a. An increase in wages.

- b. An increase in profit margins.
- c. A decrease in interest rates.
- d. A decrease in productivity.
- e. An increase in the cost of imported capital and intermediate goods.

7. Which of the following can start a cost-push increase in the price level?

- i. OPEC decides to cut oil production
- ii. the money wage rate increases
- iii. the exchange rate strengthens

- a) i and ii
- b) ii and iii
- c) iii and i
- d) None of the above.

8. Which of the following apply to the MPC in the Keynesian model?

- i. it is the slope of the consumption function
- ii. it is the inverse of the savings function
- iii. it is always less than 1

- a. i and ii
- b. ii and iii
- c. iii and i
- d. All of the above.

9. An increase in ___ will lead to a larger multiplier.

- a. exports
- b. marginal propensity to import
- c. marginal propensity to consume
- d. taxes

10.

Use the following information to answer questions 5 to 9.

Consumption expenditure = $180 + 0.9Y_d$ (where Y_d is disposable income)

Investment = 30

Government expenditure = 210

Exports = 75

Imports = $0.25Y$

$$\text{Taxes} = 2 + 0.2Y$$

Use the following information to answer questions 5 to 9.

$$\text{Consumption expenditure} = 180 + 0.9Y_d \text{ (where } Y_d \text{ is disposable income)}$$

$$\text{Investment} = 30$$

$$\text{Government expenditure} = 210$$

$$\text{Exports} = 75$$

$$\text{Imports} = 0.25Y$$

$$\text{Taxes} = 2 + 0.2Y$$

Calculate the value of the multiplier.

- a. 5.88
- b. 1.89
- c. 1.03
- d. 0.51

11. If inflation was 10% in a particular year and you received a 20% increase in income during the same year, then over the year your:

- A. real and nominal income both fell.
- B. real and nominal income both rose.
- C. real income fell, but nominal income rose.
- D. real income rose, but nominal income fell.
- E. nominal income rose, but real income was unchanged.

12. The government of an open economy determines that the current equilibrium level of income in the economy is lower than the full-employment level of income and wishes to close this gap. The Minister of Economic Affairs hears that you have just studied the Keynesian model of the macro-economy and approaches you for advice about how to increase the size of the Keynesian multiplier. Which one of the following would be appropriate in this regard?

- A. Increase the level of government spending.
- B. Reduce the level of government spending.
- C. Raise the tax rate.
- D. Encourage households to spend a larger portion of each additional unit of income they receive.

E. Encourage households to save a larger portion of each additional unit of income they receive.

13. Which of the following would NOT cause a shift in Aggregate Demand?

- a) A reduction in income tax
- b) A reduction in interest rates
- c) An increase in government spending
- d) A fall in the cost of production

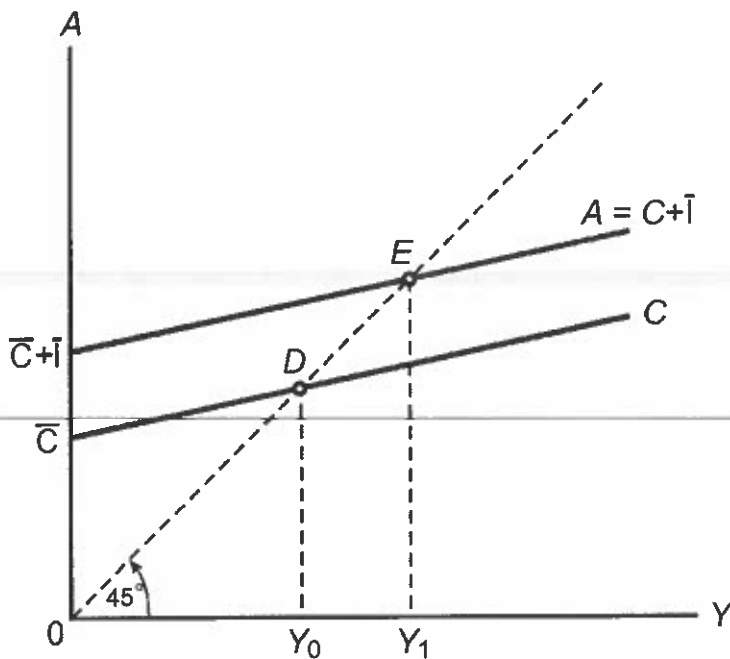
14. Determinants of exports

A key determinant of exports is:

- a) The industrial base of the economy
- b) The number of people in work
- c) The political beliefs of the government
- d) The role of the central bank

15.

Consider the following diagram and answer the question below.



Which one of the following statements is **false**?

- A. Y_1 represents the equilibrium level of income.
- B. The curve labelled $A = C + I$ shows the total of consumption and investment spending.
- C. The curve labelled C shows the total of autonomous and induced consumption spending.
- D. The point labelled D shows where saving equals investment.
- E. The point labelled E shows where planned investment equals actual investment.

16. Consider the following information:

- Marginal propensity to consume = 0,9
- Investment = R200 million
- Autonomous consumption = R70 million

The equilibrium level of income is

- A. R300 million
- B. R700 million
- C. R2 000 million
- D. R2 700 million
- E. impossible to determine from the information provided

17. Which one of the following factors will NOT increase the level of autonomous consumption?

- A. An increase in income.
- B. A decrease in the interest rate.
- C. An increase in the value of shares.

18. Which one of the following is **not** a basic aim of macroeconomic theory?

- A. To describe all the detail pertaining to a specific situation in the economy.
- B. To explain how the economy functions.

C. To predict what will happen if something changes.

D. To assist policymakers by analysing economic policy

19. Which one of the following is **not** an assumption of the simple Keynesian model?

A. Prices are given.

B. Interest rates are given.

C. Wages are given.

D. The money stock is given.

E. Production (supply) is the driving force that determines the level of economic activity.

20. Which one of the following statements is **incorrect**? In a simple Keynesian model without a government and a foreign sector:

A. aggregate spending A consists of consumption spending C and investment spending I .

B. C depends largely on total income.

C. I represents spending on capital goods.

D. I depends largely on total production and income Y .

E. there is equilibrium when $A = Y$.

21. Which one of the following statements about the consumption function is **incorrect**?

A. Consumption spending consists of autonomous consumption and induced consumption.

B. Autonomous consumption consists largely of spending on durable consumer goods.

C. Autonomous consumption is independent of the level of income.

D. As income increases, the level of induced consumption increases.

22. Which one of the following is **not** an important element of the investment decision?

A. The cost of capital goods.

~~B. The level of total income in the economy (Y).~~

C. The interest rate.

D. The expected revenue from the investment project.

E. The expected return on the investment project.

23. When considering growth over a period of time, in what circumstances can one say that a country's economy is definitely better off?

- a. When there is growth in monetary terms
 - b. When there is growth in real terms
 - c. When economic growth is higher than population growth
 - d. When there is an increase in real growth per capita
24. When considering cyclical unemployment, which one of the following statements is true?
- a. Unemployment is highest at peak times.
 - b. Employment decreases in times of recovery.
 - c. Unemployment increases in times of depression.
 - d. Employment increases in times of recession.
25. What is the best way in which to measure economic growth?
- a. Measure the GDP of the country, and calculate the percentage increase from one period to the next.
 - b. Measure the percentage increase in total production from one period to the next.
 - c. Measure the percentage decrease in unemployment and poverty from one period to the next.
 - d. Measure the percentage growth in GDP per capita from one period to the next.
26. You are given the following information about a model closed economy (without a foreign sector). The autonomous part of consumption is R100 billion. The marginal propensity to consume is equal to 0,8. Investment is R460 billion. Government purchases of goods and services are R400 billion. The tax rate is equal to 0,25. The equilibrium level of consumption is _____, and the equilibrium level of income is _____.
- A. R100 billion; R960 billion
 - B. R100 billion; R1 600 billion
 - C. R1 060 billion; R1 600 billion
 - D. R1 540 billion; R2 400 billion
 - E. R3 940 billion; R4 800 billion
- 27.

Consider the information below. Use this information to answer Questions (a) to (c)

Consider a Keynesian model where:

full employment output	= R80 million
exports	= R5 million
the marginal propensity to import out of income	= 0,25
autonomous imports	= R5 million
the tax rate	= 0,25
investment	= R20 million

autonomous consumption	= R15 million
the marginal propensity to consume	= 0,6.

A)

The value of the multiplier is:

- A. 1,25
- B. 1,333
- C. 1,538
- D. 1,818
- E. 2,5

28. Which of the following statements is/are correct? In the full Keynesian model, imports:

- i. do not play any part.
- ii. are affected by the level of income.
- iii. are always taken as autonomous.
- iv. vary with the level of exports.

- A. i
- B. ii
- C. i and iii
- D. ii and iv
- E. iv

29. How will the aggregate demand and the equilibrium income be affected by an increase in autonomous expenditure?

- a. Aggregate demand increases, equilibrium income increases
- b. ~~Aggregate demand decreases, equilibrium income increases~~
- c. Aggregate demand increases, equilibrium income decreases
- d. Aggregate demand decreases, equilibrium income decrease

30. Which one of the following statements about the 45-degree line is **incorrect**?

- A. The 45-degree line indicates all the points where the level of aggregate spending (A) is equal to the level of aggregate income (Y).

- B. The 45-degree line indicates all the possible equilibrium points.
- C. Any point above the 45-degree line indicates an excess demand for goods and services.
- D. Any point below the 45-degree line indicates an excess supply of goods and services.
- E. At the point where the aggregate spending function intersects the 45-degree line, there is an excess supply of goods and services.

Section B: Answer All

Question 1

- a) What are the main costs (or consequences) of inflation? Should the South African Reserve Bank try to combat inflation at all costs? (10 marks)
- b) Suppose you are given the following information in a Keynesian model of a closed economy: Autonomous consumption is R100 million, investment spending is R200 million, government spending is R300 million, the marginal propensity to consume is 0,8, and the tax rate is 0,25 (or 25%). You are required to calculate the equilibrium level of income (10 Marks)

Question 2

- a) Using graphs, explain the effect of the introduction of proportional income tax and government spending on an equilibrium level of income (9 marks)
- b) Who makes up the 'labour force' in a population, and who is considered to be 'unemployed'? (5marks)
- c) Assuming you are the advisor to the current president of South Africa, and the economy is currently experiencing an unemployment rate of 33.5%. Briefly explain any three supply side strategies that can be applied to reduce unemployment (6 marks)

Question 3

- d) Other than the demand-pull and Cost-push inflation, certain approaches can be used to diagnose inflation. Briefly explain any three factors that can be used to explain the inflation process (10 Marks)
- e) Briefly explain the difference between marginal propensity to save (MPS) and Marginal Propensity to Consume (MPC). In your answer, explain why these two are complements. (5 marks)
- f) With the aid of examples, illustrate and explain how an increase in the price of imported capital and intermediate goods influences the aggregate supply curve (7 marks)
- g) With the aid of examples, briefly explain any three costs of unemployment (8)

