

UNIVERSITY OF FORT HARE

Macro Economics
ECO 221/E

Supplementary Exam
2024

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Time: 3h00
Subject: ECO 221/E
Marks: 100

This paper consists of 6 pages including the cover page

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INSTRUCTIONS

This question paper is made up of three sections.

Answer **ALL** questions in section **A**.

Answer **ALL** questions in section **B**.

Choose **ANY TWO** questions from section **C**.

Multiple Choice Questions

1. Traditional Keynesians tend to favor
 - a. fiscal policy over monetary policy because of the liquidity trap.
 - b. monetary policy over fiscal policy because of the effectiveness of central banks.
 - c. monetary policy over fiscal policy because it reduces interest rates.
 - d. fiscal policy over monetary policy because it doesn't impact interest rates.

2. Government expenditure is financed in the following ways except..
 - a. Taxation
 - b. Sale of bonds
 - c. Money creation
 - d. Interest rate

3. Technology is an exogenous factor of production in the aggregate production function.
 - a. True
 - b. False

4. The Classical economists were interventionist as they did not favour active monetary and fiscal policies to stabilise the economy.
 - a. True
 - b. False

5. Gross National Product includes the current production of final goods and services within the country's borders.
 - a. True
 - b. False

6. In the base year, the relationship between nominal and real GDP is
 - a. uncertain
 - b. real GDP is higher.
 - c. nominal GDP is higher.
 - d. one of equality.

7. A decline in the money stock will:
 - a. shift the LM schedule to the left.
 - b. shift the LM schedule to the right.
 - c. not have any effect on the LM schedule.
 - d. shift the IS schedule downwards and to the right.

8. What is the Mundell-Fleming model primarily used to analyze?
- Closed economy monetary policy
 - Closed economy fiscal policy
 - Open economy fiscal policy
 - Open economy monetary policy
9. According to Keynesian System III, how does a decrease in the money supply affect aggregate income and output?
- Both aggregate income and output increase
 - Aggregate income and output remain unchanged
 - Both aggregate income and output decrease
 - Aggregate income increases, but output decreases
10. In the Mundell-Fleming model, a decrease in government spending is likely to lead to:
- An appreciation of the domestic currency
 - A depreciation of the domestic currency
 - An increase in interest rates
 - A decrease in income
11. Which one of the following factors does not determine the natural rate of unemployment and output.
- money supply
 - capital stock
 - size of the labor force
 - level of technology
12. If a country experiences an increase in its money supply in the Mundell-Fleming model, what is the a likely effect on its exchange rate?
- Appreciation of the domestic currency
 - Depreciation of the domestic currency
 - No effect on the exchange rate
 - Uncertain effect depending on capital flows
13. If the short-run IS-LM equilibrium occurs at a level of income below the natural level of output, then in the long run the price level will _____, shifting the _____ curve to the right and returning output to the natural level.
- increase; IS
 - decrease; IS
 - increase; LM
 - decrease; LM

14. _____ move output above the natural rate and move the unemployment rate below the natural rate for a time and would also cause prices to rise.
- decrease in money supply
 - increase in interest rate
 - increase in government expenditure
 - decrease in government expenditure.
15. According to the Mundell-Fleming model, which policy mix would be most effective in increasing domestic income without affecting the exchange rate?
- Expansionary fiscal policy and contractionary monetary policy
 - Contractionary fiscal policy and expansionary monetary policy
 - Expansionary fiscal policy and expansionary monetary policy
 - Contractionary fiscal policy and contractionary monetary policy
16. 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.
17. Along any IS curve:
- both government spending and expectations are fixed.
 - government spending and the price level may vary.
 - consumption and the price level are fixed.
 - both government spending and tax rates may vary.
18. The equation for the BoP schedule can be written as:
- $X(Y_f, \pi) - Z(Y, \pi) + F(r - r_f) = 0$.
 - $S(Y) + T + Z(Y, \pi) = I(R) + G + X(Y_f, \pi)$.
 - $M = L(Y, r)$.
 - $Y = C + I + G + X - Z$.
19. What is the Mundell-Fleming model primarily used to analyze?
- Closed economy monetary policy
 - Open economy monetary policy
 - Closed economy fiscal policy
 - Open economy fiscal policy

20. According to Keynesian System III, how does a decrease in the money supply affect aggregate income and output?
- Both aggregate income and output increase
 - Both aggregate income and output decrease
 - Aggregate income and output remain unchanged
 - Aggregate income increases, but output decreases
21. In the Mundell-Fleming model, a decrease in government spending is likely to lead to:
- An appreciation of the domestic currency
 - A depreciation of the domestic currency
 - An increase in interest rates
 - A decrease in income
22. Which one of the following factors does not determine the natural rate of unemployment and output.
- money supply
 - capital stock
 - size of the labor force
 - level of technology
23. If the short-run IS-LM equilibrium occurs at a level of income below the natural level of output, then in the long run the price level will _____, shifting the _____ curve to the right and returning output to the natural level.
- increase; IS
 - decrease; IS
 - increase; LM
 - decrease; LM
24. _____ move output above the natural rate and move the unemployment rate below the natural rate for a time and would also cause prices to rise.
- decrease in money supply
 - increase in interest rate
 - increase in government expenditure
 - decrease in government expenditure.
25. According to the quantity theory, inflation is controlled by:
- private firms who set prices.
 - the monetary authorities who control the money supply.
 - those who control output.
 - the price of oil.

SECTION B: (COMPULSORY)**[25]****Question 1 [5]**

Briefly discuss Friedman's natural rate theory of unemployment. What does the theory entail?

Question 2 [10]

Explain 3 approaches that can be used to measure Gross Domestic Product of an economy.

Question 3 [10]

Define monetary policy and describe the tools used by the SARB to conduct its monetary policy.

SECTION C: (ANSWER ANY TWO QUESTIONS FROM THIS SECTION)**[50]****Question 1 [25]**

- a. What is meant by wage rigidity? With specific reference to South Africa, discuss the three sources of wage rigidity that have led to Keynes' adopting a contractual view of the labour market. [15]
- b. Use the graph of the aggregate production function to explain the derivation of the marginal productivity of labour schedule. Explain the properties of this schedule. [10]

Question 2 [25]

- a) Compare the policy conclusions formed under the classical and Keynesian AD-AS models. [10]
- b) Illustrate and explain the effect of an Expansionary Fiscal Policy under Fixed Exchange Rates and Imperfect Capital Mobility [15]

Question 3 [25]

- a. Illustrate and explain the effects on interest rates and income (output) in the IS-LM model if an expansionary monetary policy is implemented [10]
- b. Illustrate and explain why Friedman concluded that the long-run Phillips curve is vertical at the natural rate of unemployment.– Hence, monetary policy could be effective in the short run but not in the long run. [15]