

UNIVERSITY OF FORT HARE  
ALICE AND EAST LONDON

ECO 121/ECO 121E

DEGREE EXAMINATIONS  
SUPPLEMENTARY EXAMINATION  
JANUARY 2019

Time: 3 HOURS

Subject: INTRODUCTION TO ECONOMICS (MACROECONOMICS)

Marks: 100

This paper consists of 19 pages including the cover page

Internal Examiners

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Ms A. Jiza  
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INSTRUCTIONS

Answer All Questions in Section A  
Answer ANY two Questions in Section B

Make use of relevant contemporary examples where applicable. The graphical illustrations must be clearly shown.

SECTION A

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ANSWER ALL QUESTIONS IN THIS SECTION

EACH QUESTION IN THIS SECTION CARRIES 1 (ONE) MARK

Question 1

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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.

Question 2

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Which one of the following statements is incorrect?

- A. Market economies cannot function without some government involvement.
- B. Markets do not always produce efficient outcomes – markets sometimes fail.
- C. Markets always produce equitable outcomes.
- D. Market systems tend to experience business cycles, that is, cyclical upswings and downswings in aggregate economic activity.
- E. The transfer of ownership from a private enterprise to the government is called nationalisation.

Question 3

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Which one of the following is not part of fiscal policy?

- A. The budget.
- B. The level of taxation.
- C. The composition of government expenditure.
- D. The stock of money in the economy.
- E. Borrowing by the government.

Question 4

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Which one of the following does not pertain to fiscal policy?

- A. The minister of finance
- B. The budget deficit
- C. Private investment
- D. Tax increases
- E. Government spending cuts

Question 5

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.

Question 6

Which one of the following does NOT represent a key macroeconomic variable?

- A. The unemployment rate.
- B. The inflation rate.
- C. Gross Domestic Product (GDP).
- D. Income distribution.
- E. The population growth rate.

Question 7

If we were to add up the value of output of all firms in the economy, we would:

- A. obtain GDP at factor cost.
- B. obtain GDP at market prices.
- C. obtain GDP using the income method.
- D. overestimate the value of production taking place in the economy.
- E. underestimate the value of production taking place in the economy.

Question 8

Questions (8) and (9) are based on the table below, which describes the process by which a loaf of bread is made available to a consumer as a final good.

	Price (R) of a loaf of bread
Farmer sells wheat to miller	5,00
Miller sells flour to baker	6,00
Baker sells bread to grocer	10,00
Grocer sells bread to consumer	12,00

The total value of a loaf of bread is:

- A. R7,00
- B. R12,00
- C. R4,00
- D. R33,00
- E. R10,00

Question 9

The value added by the grocer equals:

- A. R12,00
- B. R10,00
- C. R2,00
- D. R5,00
- E. R4,00

Question 10

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

Question 11

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.

Question 12

Which of the following is not a legitimate area of intervention by government in a mixed economy?

- A. Regulation of the pricing behaviour of monopoly industries.
- B. Regulation of price increases that result from changes in patterns of demand and supply in competitive markets.
- C. Stabilisation of the economy during periods of cyclical instability.
- D. Redistribution of purchasing power via progressive taxation and transfers.
- E. The provision of funds for public goods such as parks and street lights.

Question 13

Which of the following is least likely to be associated with market failure, and is consequently least likely to require any form of state regulation or intervention?

- A. Hake fishing off the west coast of South Africa.
- B. The provision of education services in government schools.
- C. The provision of education services in private schools.
- D. The market for fast foods.
- E. The provision of lifeguards on Durban's beaches.

Question 14

Which of the following is likely to lead to an increase in inflation?

- A. An increase in taxes.
- B. Monetary and credit policies that reduce private consumption.
- C. More efficient public activities.
- D. An increase in money-financed spending by government.
- E. None of the above.

Question 15

To derive GDP at market prices from Gross Domestic Expenditure, we must:

- A. subtract spending on exports and add spending on imports.
- B. subtract spending on imports and add spending on exports .
- C. subtract spending on intermediate goods and add spending on exports.
- D. subtract spending on exports and add spending on intermediate goods.
- E. subtract spending on net exports.

Question 16

The table below shows a section of the national accounts for a small country in 2012. Answer Questions (16) and (17) using the information provided in the table.

Consumption expenditure	10 500
Government expenditure	3 000
Depreciation	500
Exports	1 200
Imports	1 000
Gross capital formation (investment)	2 200

The value of Gross Domestic Expenditure is:

- A. 15 900
- B. 15 200
- C. 15 400
- D. 18 400
- E. 15 700

Question 17

The value of Net Domestic Product is:

- A. 15 900
- B. 15 700
- C. 15 200
- D. 15 400
- E. 18 400

Question 18

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In a country with a population of 50 million people, there are 20 million children under the age of 15 years, 16 million employed, 9 million pensioners, 4 million unemployed and 1 million people who are physically unable to work. The unemployment rate in this country equals:

- A. 8%
- B. 10%
- C. 13,3%
- D. 20%
- E. 25%

Question 19

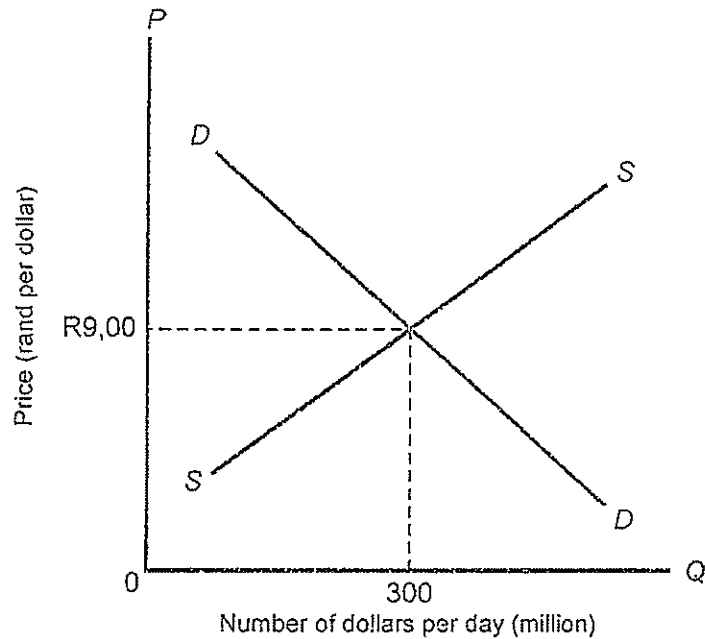
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A consumer's real purchasing power refers to:

- A. the nominal income level of the consumer.
- B. wage income earned through employment.
- C. the maximum volume of goods and services that the consumer can buy.
- D. nominal GDP per capita.
- E. real GDP deflated by the price level.

Question 20

The figure below shows the demand and supply curves for dollars (in terms of the South African rand) in the foreign exchange market. Use this information to answer the question below.



In this case, an increase in American tourists to South African game reserves would cause the:

- A. supply curve to shift to the right.
- B. demand curve to shift to the left.
- C. supply curve and demand curve to remain unchanged.
- D. demand curve to shift to the right.
- E. supply curve to shift to the left.

Question 21

Which of the following options is/are true? At the equilibrium level of national income:

- i. aggregate spending equals aggregate production.
  - ii. aggregate spending equals aggregate income.
  - iii. aggregate income equals aggregate production.
  - iv. aggregate income equals aggregate production, but the level of aggregate spending is irrelevant.
- A. i
  - B. ii
  - C. iii
  - D. i, ii and iii
  - E. i and iv

**Question 22**

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In the simplest (or introductory) form of the Keynesian model, which of the following decisions can we analyse?

- A. Interest rate fluctuations.
- B. Saving of households.
- C. Investment by government.
- D. Foreign investment by firms.
- E. Wage levels in firms.

**Question 23**

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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.

**Question 24**

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Equilibrium refers to a situation where:

- A. the key quantities are equal.
- B. all the variables balance out, i.e., their sum is zero.
- C. all resources are fully employed.
- D. no participant in the process desires to change his or her behaviour.
- E. production equals income.

**Question 25**

Nominal GDP calculated at market prices differs from nominal GDP at factor cost. Which of the following items would account for the difference?

- A. Depreciation on capital equipment.
- B. Inflation.
- C. Interest on loans.
- D. Indirect taxes and subsidies.
- E. Net incomes from abroad.

Question 26

If 2010 is the base year for real GDP calculations, we know for certain that nominal GDP:

- A. is less than real GDP in 2010.
- B. is greater than real GDP in 2010.
- C. equals real GDP in 2010.
- D. in 2009 was greater than real GDP in 2010.
- E. in 2009 was less than real GDP in 2010.

Question 27

GDP at \_\_\_\_\_ prices will usually be greater than GDP at \_\_\_\_\_ prices because of \_\_\_\_\_.

- A. constant; current; inflation
- B. current; constant; inflation
- C. constant; current; depreciation
- D. current; constant; depreciation
- E. current; constant; deflation

Question 28

Consider the case of two countries, Afghanistan and the US, both producing carpets and fighter aircraft. The table below shows output rates per day in the two countries if all resources are fully and efficiently employed. Use this information to answer Questions (28), (29) and (30).

	Carpets	Fighter aircraft
Afghanistan	100	4
US	500	25

Based on this information:

- A. there is no opportunity for mutually beneficial trade between the two countries.
- B. Afghanistan has an absolute advantage in the production of both goods.
- C. Afghanistan should import carpets from the US.
- D. Afghanistan has a comparative advantage in the production of aircraft.
- E. the US should export fighter aircraft to Afghanistan.

Question 29

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An appropriate international exchange ratio that would allow mutually advantageous trade to take place would be:

- A. 1 aircraft = 25 carpets.
- B. 1 aircraft = 20 carpets.
- C. 1 carpet = 4 aircraft.
- D. 1 carpet = 0,04 aircraft.
- E. 1 aircraft = 22 carpets.

Question 30

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If Afghanistan raised its aircraft productivity to 5 units per day, then:

- A. mutually beneficial trade would no longer be possible.
- B. Afghanistan would continue to import fighter aircraft from the US.
- C. Afghanistan should switch from the export of carpets to the export of aircraft.
- D. the US would retain its comparative advantage in carpet manufacture.
- E. the US would retain its absolute disadvantage in the manufacture of both goods.

Question 31

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In the Keynesian model, government expenditure:

- A. is undertaken solely to regulate the level of spending.
- B. increases with investment because investment increases the size of the tax base.
- C. is taken to be autonomous because it is subject to government policy.
- D. can be ignored because investment is taken to be the key determinant of income.
- E. is determined by the level of tax revenue.

Question 32

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In the Keynesian model, tax revenue:

- A. does not appear in the aggregate expenditure function because it is always equal to government expenditure.
- B. is taken into account through its effect on consumption.
- C. reduces equilibrium income because it reduces autonomous spending.
- D. increases aggregate expenditure because government invariably increases its spending when taxes rise.
- E. is taken to be fixed because government expenditure is taken to be fixed.

### Question 33

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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

### Question 34

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In the Keynesian model, government expenditure:

- A. is undertaken solely to regulate the level of unemployment.
- B. affects the size of the multiplier because it varies with income.
- C. always increases when taxes increase because government has more to spend.
- D. can be ignored if it equals the level of taxation.
- E. is taken to be independent of income because government decides on the level.

### Question 35

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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.

### Question 36

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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.

Question 37

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Which one of the following statements is correct?

- A. The aggregate demand curve (AD curve) can be shifted by monetary as well as fiscal policy measures.
- B. A restrictive fiscal policy will result in a rightward shift of the aggregate demand curve.
- C. A general increase in wages in the economy will, ceteris paribus, shift the aggregate supply curve downward (to the right).
- D. A supply shock results in a simultaneous increase in prices and production in the economy.
- E. None of the above statements is correct.

Question 38

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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.

Question 39

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Bracket creep would be eliminated if tax rates were based on:

- A. nominal income.
- B. real income.
- C. per capita income.
- D. real disposable income.
- E. nominal disposable income.

Question 40

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If the real interest rate is negative, then:

- A. the inflation rate is larger than the nominal interest rate.
- B. the inflation rate is smaller than the real interest rate.
- C. the inflation rate is smaller than the nominal interest rate.
- D. lenders will gain.
- E. the real value of a loan will increase.

Question 41

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Simon borrowed R10 000 from the bank at the end of 2011 at a fixed interest rate of 20%. At the end of 2012, the inflation rate was 25%. Inflation has been \_\_\_\_\_ to Simon; the real value of his loan plus interest payments changed to \_\_\_\_\_.

- A. beneficial; R9 600
- B. beneficial; R4 800
- C. beneficial; R8 000
- D. costly; R12 500
- E. costly; R10 500

Question 42

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A depreciation of the rand may have inflationary consequences in South Africa because it:

- A. increases the costs of exports.
- B. discourages savings.
- C. decreases the international competitiveness of South African producers.
- D. increases the costs of imported goods.
- E. discourages exports.

Question 43

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In an industry, if wages increase more than the productivity of workers, we would expect:

- A. an upward pressure on prices.
- B. a decrease in unemployment.
- C. investment in the industry to increase.
- D. costs of production to fall.
- E. the demand for labour to rise.

Question 44

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A rightward shift of the Phillips curve:

- A. indicates that the trade-off between inflation and unemployment has become less severe.
- B. is associated with deflation.
- C. might be the result of a decrease in the price of imported capital goods.
- D. indicates an expansion in economic output.
- E. indicates that every level of inflation is associated with more unemployment than before.

Question 45

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Stagflation refers to:

- A. stagnant prices.
- B. hyperinflation.
- C. the trade-off between inflation and unemployment.
- D. rising inflation accompanied by rising unemployment.
- E. jobless growth.

Question 46

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The expanded definition of unemployment in South Africa includes those people who:

- A. do not work full time.
- B. are available for employment but who are not actively seeking employment.
- C. do not earn a wage above the minimum wage.
- D. work in the informal sector.
- E. A and B above.

Question 47

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In South Africa, the strict definition (and rate) of unemployment is different from the expanded or broad definition (or rate) of unemployment because the strict rate excludes:

- A. people working in the informal sector.
- B. people who are involuntarily unemployed.
- C. people who work in subsistence agriculture.
- D. discouraged work-seekers who are not actively looking for work.
- E. all of the above.

Question 48

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During a recession, cyclical unemployment will \_\_\_\_\_ and cyclical inflation will \_\_\_\_\_.

- A. decrease; decrease
- B. decrease; increase
- C. increase; increase
- D. increase; decrease

**Question 49**

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The phase of the business cycle at which almost all available resources in the economy are in use is referred to as:

- A. the recovery phase.
- B. the expansion phase.
- C. the peak or boom phase.
- D. the trough phase.

**Question 50**

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Keynesians believe that the fluctuations in economic activity (business cycles):

- A. are caused by external factors such as the inappropriate use of government policy.
- B. are caused by changes in weather patterns.
- C. are caused by structural or institutional changes.
- D. occur naturally in market economies and require government intervention.

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**SECTION B**

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**ANSWER ANY TWO QUESTIONS IN THIS SECTION**

**EACH QUESTION CARRIES EQUAL MARKS**

**Question 1**

- a. Use examples to explain the difference between absolute advantage and comparative (or relative) advantage in international trade. (6)
- b. 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? (10)
- c. Discuss the Three main motives for holding money. (9)

### Question 2

- a. Explain the difference between nominal values and real values. How does this relate to purchasing power? (6)
- b. Briefly discuss four channels through which a change in the repo rate may potentially affect the price level and the level of real output in the economy. (12)
- c. What is meant by the consumption function? Use a diagram to explain the three main characteristics of the consumption function. (7)

### Question 3

Assuming that the economy of South Africa produces three goods: Cars, Laptops and Houses. The accompanying table shows the output and prices for years 2006 and 2007.

Year	Cars		Laptops		Houses	
	Price	Quantity	Price	Quantity	Price	Quantity
2006	R100	1	R10	8	R5	4
2007	R110	1	R12	10	R4	5

- (i) Calculate the nominal GDP for:
- a) 2006 (2)
- b) 2007 (2)
- (ii) Compute the percentage of growth in nominal GDP from 2006 to 2007. (2)
- (iii) Using 2006 as the base year, calculate the real GDP for 2007. (2)
- (iv) What is the GDP deflator for 2007? What was the inflation rate between 2006 and 2007? (4)
- (v) Discuss the main economic arguments in favour of and against the privatisation of public corporations such as Eskom and Transnet. (6)
- (vi) With a fully labelled graph illustrate and explain asymmetric information as a market failure. (7)

Question 4

- a.) Calculate the equilibrium level of income if  $C = R100 \text{ million} + 0,8Y$  and  $\bar{T} = R125 \text{ million}$ . (5)
- b.) Can monetary and fiscal policy be used to counteract (or combat) demand-pull inflation? Use a diagram (or diagrams) to explain your answer. (10)
- c.) With the aid of a diagram, discuss whether a conventional Phillips curve be used to provide an illustration of stagflation? (10)

END OF PAPER

SECTION A: MULTIPLE CHOICE ANSWER SHEET

NAME.....STUDENT NO:..... COURSE.....

Indicate your choice by making a CROSS in the choice block:

Question number	Options: choose only one				
	USE an 'X' to select your answer				
1	a	b	c	d	e
2	a	b	c	d	e
3	a	b	c	d	e
4	a	b	c	d	e
5	a	b	c	d	e
6	a	b	c	d	e
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10	a	b	c	d	e
11	a	b	c	d	e
12	a	b	c	d	e
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