

UNIVERSITY OF FORT HARE

ADVANCED
MACROECONOMICS
ECO 613E

DEGREE EXAMINATIONS

NOVEMBER EXAMINATIONS

2019

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Time: 3 Hours
Subject: ECO 613E
Marks: 100

This paper consists of 3 pages including the cover page

Internal Examiners

Prof SI Ikhide

Dr FM Kapingura

External Examiners

Prof H Eita

INSTRUCTIONS

Answer QUESTION 1 in Section A
Answer ANY THREE questions in Section B
All questions carry equal marks

SECTION A: Compulsory

1. The following is a simple Keynesian model:

$$S(Y) = I(i) + G$$

$$M/P = L(Y,i)$$

With G exogenous and M/P constant,

- (a) Derive mathematical expressions describing the effects of a change in government purchases of goods and services (G) on income (Y) and interest rates (i). (5 marks)
- (b) How would the effects of G on Y differ in the classical case? (2.5 Marks)
- (c) Using a linearized Keynesian model, solve for IS and LM. (2.5 marks)
- (d) Discuss the IS and LM curves, their slopes and intercepts, and the way that they respond to changes in money supply, prices, and government expenditures (5 marks)
- (e) Explain the paradox of thrift. (5 marks)
- (f) Using the IS and LM curves show graphically and explain the major factors in determining the effectiveness of monetary and fiscal policy. (5 marks)

SECTION B

2. (a) In what market are interest rates determined in the neoclassical model? Explain this market and the meaning and significance of interest rates in this model. What does it mean to say that the neoclassical theory of interest is a real theory of interest? What is the Wicksellian natural rate of interest? (15 marks)

(b) What arguments does Keynes offer to support his position that inadequate investment is the source of deficient effective demand? What is effective demand, and how does it differ from notional demand? How does inadequate investment arise and then result in unemployment in Keynes model? Explain. (10 marks)

3. (a). Explain the Permanent Income Hypothesis (PIH) of Friedman and the Life Cycle Hypothesis (LCH) of Modigliani. What are the differences and similarities in the two theories? In what ways is the PIH distinctly neoclassical? (20 marks)

(b). What do these theories imply about the sensitivity of (current) consumption to changes in (current) income? (5 marks)

4. (a). What should be the main objectives of government macroeconomic policy? (5 marks)

(b). What are the main sources of government failures in macroeconomic management in developing countries? Explain with special reference to South Africa. (20 marks)

5. Despite all of their talk about the Laffer Curve, Supply-Siders sometimes appear to be really advocating no taxes.

(a) Explain the reasons why Supply-Siders view progressive taxes as detrimental to growth and the cause of much trouble in the macroeconomy. [10 Marks]

(b) What is the tax wedge and what is its importance in explaining the disincentive effects of taxes? [5 Marks]

(c) Governments do incur expenses that must be offset (at least partly) by taxes. According to the Supply-Siders, what is the appropriate way to tax? [10 Marks]