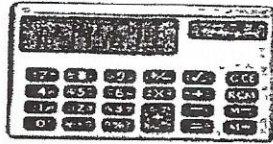


MEMO

UNIVERSITY EXAMINATIONS



UNIVERSITEITSEKSAMENS

UNISA  university of south africa

ECS1601

(473773)

May/June 2017

ECONOMICS IB

Duration 2 Hours

100 Marks

EXAMINERS

FIRST

SECOND

MRS MR MALEFANE
MR FHB SERFONTEIN

Use of a non-programmable pocket calculator is permissible

Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue

This paper consists of 22 pages including 1 page for rough work (page 22) plus the special front page

Read all instructions CAREFULLY before answering the questions.

This paper consists of two (2) sections A and B All sections are compulsory

Section A consists of four (4) questions Answer all the questions in section A in the space provided

Section B consists of 30 multiple-choice questions Answer all the questions on the mark-reading sheet and supply your answers on the worksheet that appears on page 21 (in case your mark-reading sheet gets lost) The instructions for completing the questions of section B are on page 11 and the questions for section B appear from page 12 to page 20

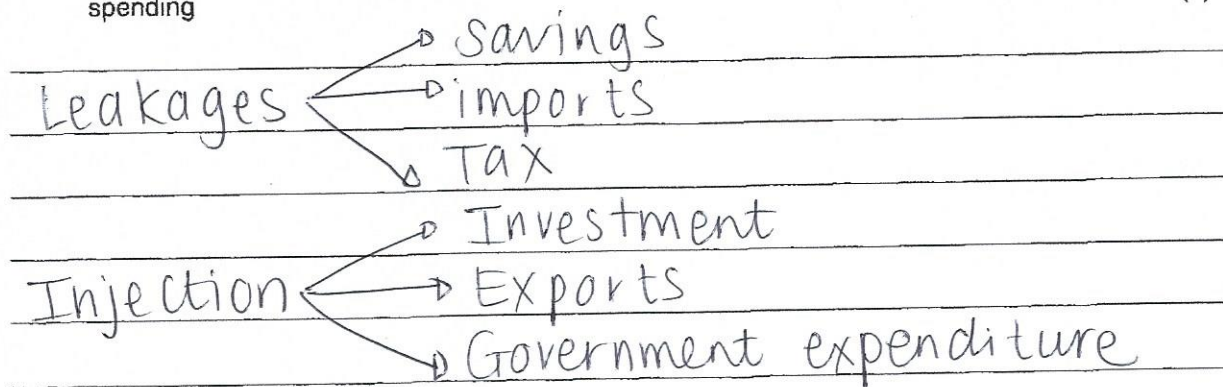
Please complete the attendance register on the back page, tear off and hand to the invigilator.

[TURN OVER]

Question 1

(11 marks)

- (i) List two important injections and two important leakages from the circular flow of income and spending (2)



- (ii) Briefly explain the relationship between the demand for money and the interest rate (3)

Indirect / negative relationship between interest rate and demand for money
 When interest rate increases the opportunity cost of holding money increases, you will hold less money and therefore demand for money decreases.

- (iii) Briefly describe an expansionary fiscal policy (2)

Expansionary fiscal policy is when government expenditure increase and/or taxes decrease. They can be used separately or together to boost economic activity.

[TURN OVER]

(iv) Identify and briefly describe one macroeconomic objective

(2)

Economic growth = change in real GDP
calculated as the percentage increase
on year on year of real GDP.

(v) Briefly explain why the link between the interest rate and investment spending is important in the
monetary transmission mechanism

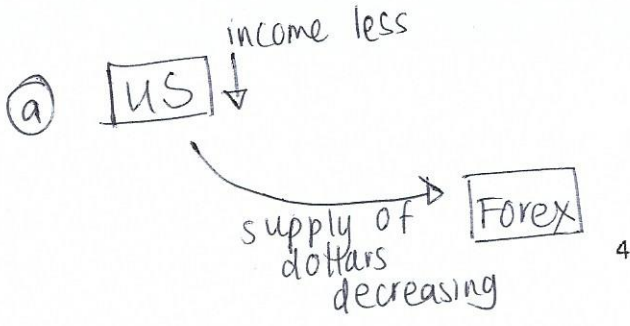
(2)

When interest rate increases, investment spending decreases and so the aggregate output/income decreases. The interest rate has to affect investment spending in order to affect output/income.

If investment spending does not react to a change in the interest rate, that means that output/income will also not react and that means the monetary transmission mechanism breaks down (if investment is inelastic)

→ Keynesian graph/model
AD/AS graph model
Investment graph

[TURN OVER]

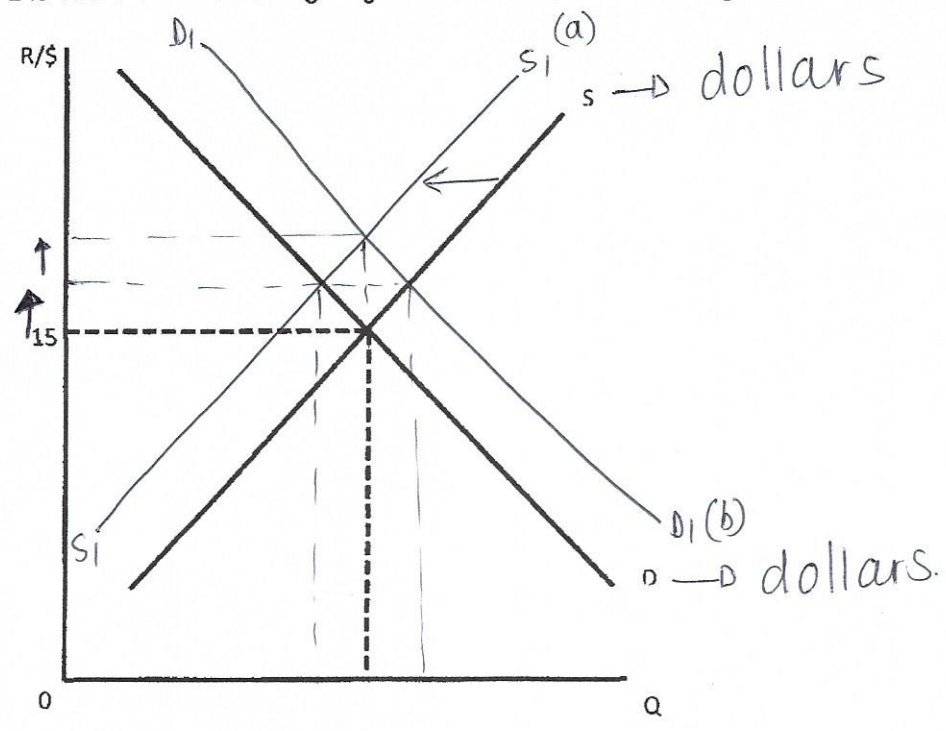


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Question 2

(8 marks)

Question 2 is based on the following diagram of the rand/dollar exchange market



Use the above diagram to illustrate and explain the impact of the following events on the rand/dollar exchange market

- a An economic recession occurs in the economies of major trading partners of South Africa
 - b Foreign investors sell South African financial assets
- (8)

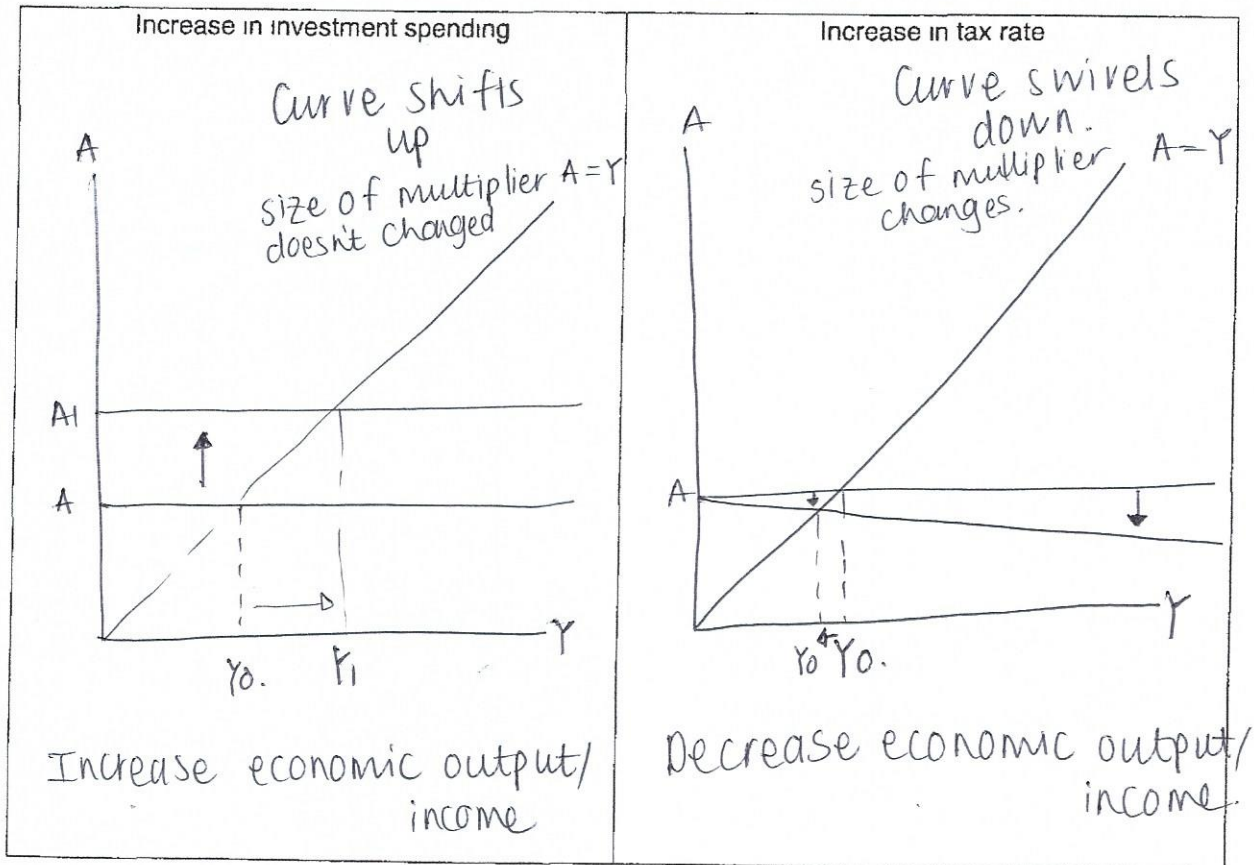


[TURN OVER]

Question 3

(12 marks)

Question 3(i) is based on a simple Keynesian model with a government sector



- (i) Use diagrams to illustrate the impact of
- (a) an increase in investment spending (5)
- (b) an increase in the tax rate (5)

Make sure you comment on the size of the change in the level of income and output for (a) and (b)

a) Level Income increases. α = unchanged

b) Level of Income decreases. α = decreases.

[TURN OVER]

- (ii) Identify two factors that can cause an increase in the value of the multiplier in a simple Keynesian model with a government and foreign sector (2)

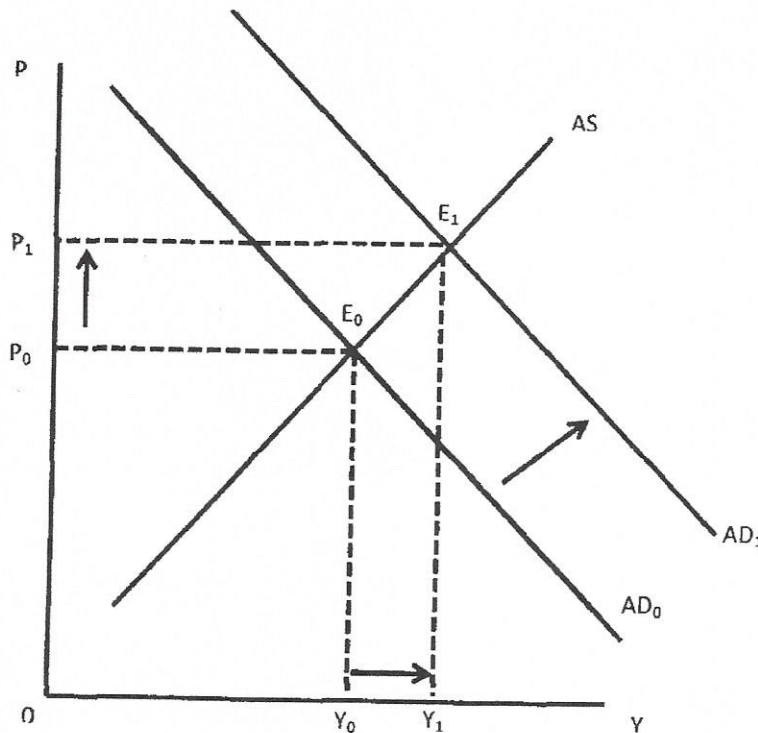
- Marginal propensity to consume increases
- tax rate decreases.
- marginal propensity to import decreases

[TURN OVER]

Question 4

(8 marks)

Question 4(i) is based on the following AD-AS model



In this model certain events took place that led to an increase in the price level and an increase in the level of output and income

- (i) Use the diagram to identify what possible events could have caused this end result and describe how these events led to these results (4)

• Expansionary monetary policy or Expansionary fiscal policy

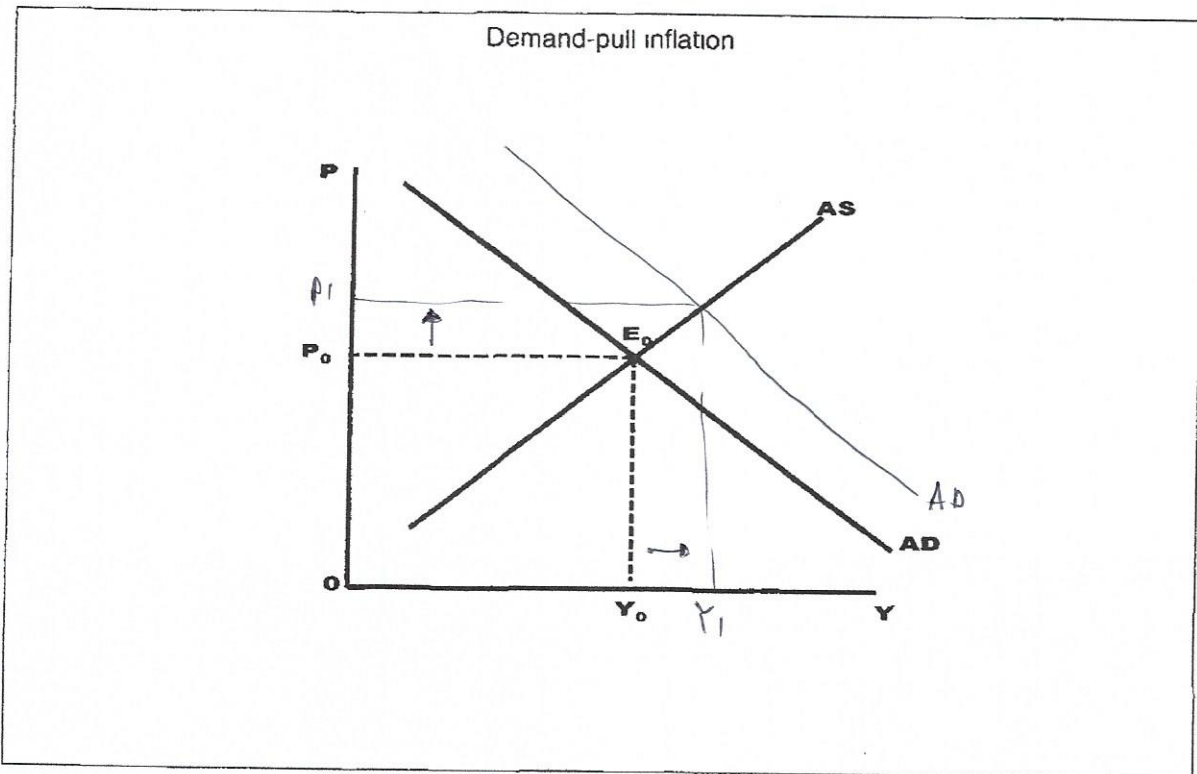
• Decrease in interest rate (monetary policy)

• Increase in government expenditure or a decrease in tax. } fiscal policy.

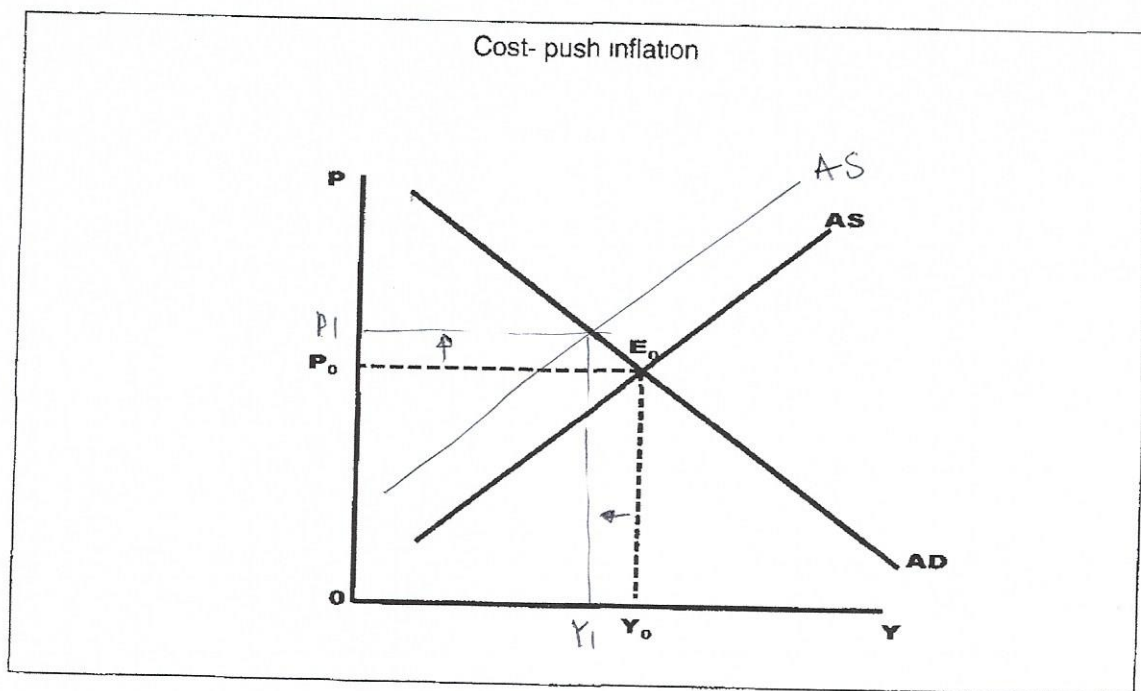
increased spending leads to increased production and prices increase.

[TURN OVER]

- (ii) Use the following diagrams to illustrate the difference between demand-pull and cost-push inflation (4)



[TURN OVER]



Question 5

(11 marks)

- (i) Structural unemployment is a serious issue that needs to be dealt with in South Africa. Describe structural unemployment and possible solutions for structural unemployment (5)

Mismatch between workers qualifications and job requirements. Workers do not have the skills for the jobs.

Solution: Increase education (long term solution)

[TURN OVER]

- (ii) During the past few years South Africa has experienced low economic growth rates. One way of explaining economic growth is to look at the demand factors and the supply factors that determine economic growth. Identify two demand factors and two supply factors of economic growth and explain the possible impact these factors might have on economic growth in South Africa. (6)

Supply : Natural resources.

Labour (labour productivity)

Capital (Machinery & Entrepreneurship)

Technology

Demand : Domestic demand increase

Increase in exports

Import substitution.

SECTION B**INSTRUCTIONS**

In this section, questions must be answered on the **mark-reading sheet** that is supplied **Carefully follow the instructions for the completion of a mark-reading sheet**

- (i) Suppose a question reads as follows

An increase in the level of production _____

- [1] decreases the level of income in the economy
- [2] has no impact on the level of income in the economy
- [3] increases the level of income in the economy
- [4] causes firms to employ less factors of production

The correct answer is [3] You must therefore mark {3} on your mark-reading sheet

- (ii) Only one of the alternatives per question – listed as [1], [2], etc – is correct You must therefore not mark more than one alternative per question
- (iii) For a correct answer, you will receive $1\frac{2}{3}$ marks No marks are deducted for incorrect answers
- (iv) Section B consists of **30 questions** and thus counts **50 marks** out of a total of 100

Your mark-reading sheet may get lost. Therefore, also write your answers to the questions of this section on page 21 of your examination answer book.

[TURN OVER]

B1 Which one of the following statements on the remuneration of the factors of production is true?

- [1] The remuneration for capital is ~~profit~~ interest
- [2] The remuneration for labour is ~~rent~~ wages
- [3] The remuneration for entrepreneurship is a ~~salary~~ profit
- [4] The remuneration for money is interest X
- [5] The remuneration for natural resources is rent

B2 In the circular flow of income and spending, government

- [1] injects government spending into the factor market and collects taxes from the goods market
- [2] withdraws taxes from firms and households
- [3] provides public goods and services to the factor market and receives labour from the goods market
- [4] withdraws government spending by providing it to firms and withdraws taxes from households
- [5] provides public goods and services to households and withdraws taxes from the goods market

B3 Which of the following is a leakage from the circular flow of income and spending in South Africa?

- [1] Defence expenditure by the South African government, via contracts with local military suppliers
- [2] Government purchases of textbooks for state-run schools
- [3] The sale of export fruit to the European Union
- [4] Investment by South African Breweries in a new brewery in South Africa
- [5] A decision by a major supermarket chain to sell Danish beer (have to import it)

B4 Which one of the following statements is false?

- [1] Without exchange, specialised producers cannot satisfy their wants from their own production
- [2] The division of labour takes place in production processes where each stage of the process is performed by an individual worker or groups of workers
- [3] Workers who specialise in the production process will only do so in parts of the process where they have an ~~absolute~~ advantage *comparative.*
- [4] The three main economic activities are production, consumption and exchange
- [5] A person should specialise where the opportunity costs are the lowest

[TURN OVER]

13

if i want something i must find someone who wants something that I have.

B5 Money overcomes the problem of a double coincidence of wants inherent in the barter system through its function as a

trade goods & services for other goods & services.

- [1] medium of exchange
- [2] unit of account
- [3] standard of deferred payment
- [4] store of value
- [5] financial intermediary

B6 Use the table below to find the total comprehensive measure of money for the year 2013

Monetary aggregate R million								
End of	Banknotes and coins in circulation	Cheque and transmission deposits	M1A	Other demand deposits	M1	Other short-term and medium term deposits	M2	Long term deposits
2013	87 014	549 323	636 337	495 702	1 132 039	919 270	2 051 308	462 557

Source South African Reserve Bank Quarterly Bulletin, December 2014 Statistical tables

- [1] R87 014 million
- [2] R549 323 million
- [3] R636 337 million
- [4] R2 513 865 million
- [5] R1 132 039 million

M3.

$$M3 = M2 + \text{Long term deposits.}$$

B7 Which one of the following statements is **incorrect**?

- [1] The opportunity cost of holding money balances is the interest that could have been earned if the money had been used to purchase interest-bearing assets instead
- [2] Anyone who wishes to enter into transactions in a monetary economy has to hold money as a medium of exchange
- [3] The quantity of money demanded for transaction purposes depends on the interest rate
- [4] The demand for money as an asset is also called the speculative demand for money
- [5] The quantity of money demanded for speculative purposes is negatively related to the interest rate

Demand for money $\left\{ \begin{array}{l} \text{transaction i.e. your budget (income).} \\ \text{precautionary - keeping money in case you need it} \\ \text{speculative. - } \uparrow \text{ interest rate } \uparrow \text{ opportunity cost of holding money.} \end{array} \right.$

[TURN OVER]

B8 Which one of the following correctly explains the interaction between government, households and firms in an economy?

- [1] Government receives taxes from firms and spends only on households
- [2] Government receives taxes from both households and firms and in return provides both role-players with public goods *i.e. police & fixing potholes.*
- [3] The government purchases factors from the goods market and goods from the factor market
- [4] The government produces goods which are sold in the factor market to both firms and households

B9 Fiscal policy refers to movements in aimed at influencing

- [1] government spending, the interest rate level
- [2] taxes and government spending, the exchange rate
- [3] government spending and taxes, aggregate output
- [4] the interest rate level and government borrowing, the deficit of the government

B10 Which one of the following statements regarding government failure is correct?

- [1] Government may fail due to the actions of bureaucrats who put the interest of the general public first
- [2] Government might fail due to actions of vote-seeking politicians
- [3] The idea that a government is not subject to competition prevents government from failing
- [4] Rent-seeking behaviour implies that the interests of interest groups come only after the interests of society at large

Answer question B11 below based on the information in the following table, where the numbers represent the number of units of each good produced

	South Africa	Botswana
Grapes	3	6
Textiles	4	2

B11 South Africa has a comparative advantage in the production of

- [1] grapes
- [2] textiles
- [3] grapes and textiles
- [4] neither grapes nor textiles

$$\frac{3}{4} = 0.75$$

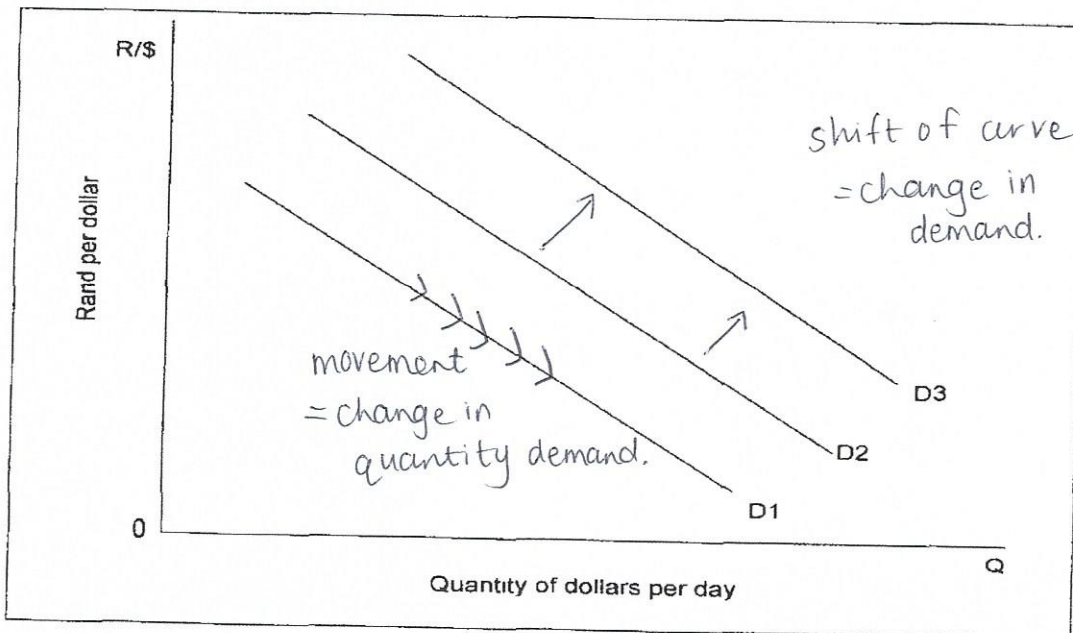
$$\frac{6}{2} = 3.$$

[TURN OVER]

B12 According to the theory of comparative advantage, a necessary condition for a country to export a good is that

- [1] the country can produce it using less labour than its trading partners
- [2] the wage rate in producing the good is lower in the country compared to its trading partners
- [3] the country has an absolute advantage in producing the good compared to its trading partners
- [4] the cost of producing the good relative to other goods, is lower compared to that of the country's trading partners

Use the figure below of a hypothetical foreign exchange market to answer question B13



B13 The shift in the demand curve from D2 to D3 can be attributed to

- [1] an increase in South African tourists to the US (sell rands in exchange for dollars)
- [2] an expectation of a decrease in value of the US dollar
- [3] a decrease in the purchase of American assets by South African investors
- [4] a decrease in the purchase of South African assets by American investors

[TURN OVER]

strict - exclude people not looking for work (discouraged workers).
expanded - include people not looking for work (discouraged workers)

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B14 Last year in the Savanna Kingdom, 50 million people worked, and 10 million people were looking for employment but did not find anything. A further 8 million people were not looking for work and did not get paid. 35 million people are under the age of 16 years. According to the strict definition, the unemployment rate in Savanna last year was

- [1] 16,7%
- [2] 20%
- [3] 55,5%
- [4] 80%

$$\text{strict} = \frac{10}{10 + 50} = 16,7\%$$

$$\text{expanded} = \frac{10 + 8}{10 + 8 + 50} = 26\%$$

B15 In 2015, Mr Sipho bought a used 2014 Kia Rio from his colleague for his wife. In addition, he bought a new 2015 South African produced Ford Ranger for himself and sold the 2010 Ford Figo he was using to his brother-in-law. Which of these purchases will be included in the GDP in 2015?

- [1] purchase of the Kia Rio
- [2] purchase of the Ford Ranger
- [3] sale of the Ford Figo
- [4] all of the sales and purchases above

* only new goods
* second-hand goods were already included previously

Question B16 is based on the following information

The saving function is $S = -1000 + 0,25Y$ and autonomous investment spending = 100

B16 What is the aggregate spending equation?

- ~~[1]~~ A = 1 000 + 0,25Y
- [2] A = 1 000 + 0,75Y
- ~~[3]~~ A = 1 100 + 0,25Y
- [4] A = 1 100 + 0,75Y

$$\text{mps} = 0,25 \therefore \text{mpc} = 0,75$$

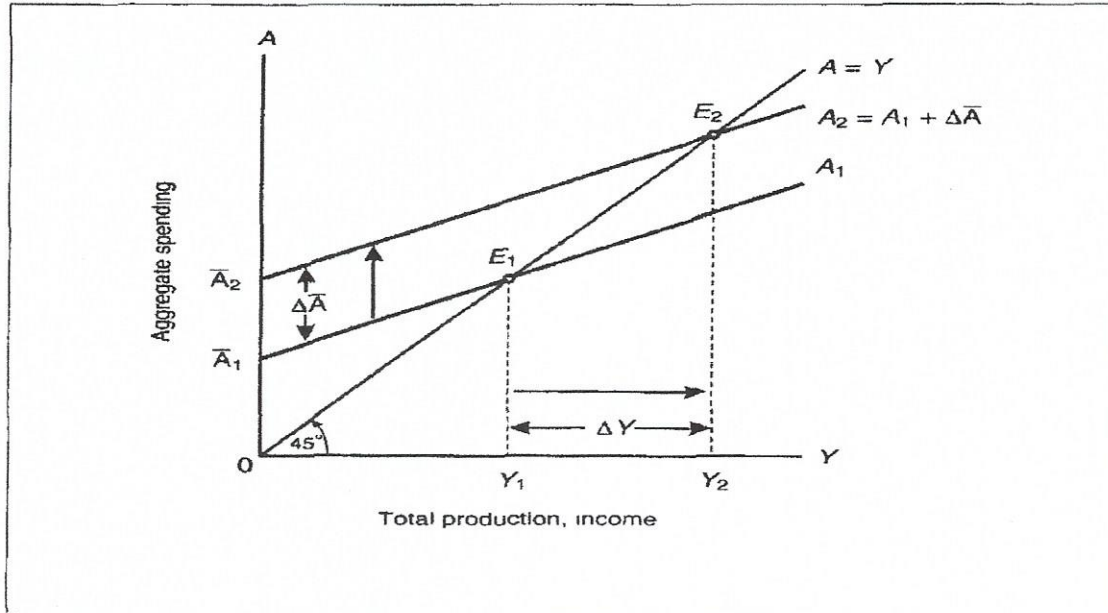
Reverse of saving + autonomous spending.
 $= 1100 + 0,75Y$

B17 Given an autonomous consumption spending of R100 and a marginal propensity to save of 0,35, what is the consumption function?

- [1] 100 + 0,35Y
- [2] 100 + 0,65Y
- [3] -100 + 0,35Y
- [4] -100 + 0,65Y

[TURN OVER]

Question B18 is based on the diagram below



B18 Given a consumption function $C = 1\,000 + 0,4Y$ with a proportional income tax rate of 40%, what is the multiplier? Round off your answer to two digits after the decimal

- [1] 1,32
[2] 1,70
[3] 2,50
[4] 2,78

$$\frac{1}{1 - C(1 - t)}$$

$$= \frac{1}{1 - 0,4(1 - 0,4)}$$

$$= \frac{1}{0,76} = 1,32 \rightarrow$$

B19 Assume the marginal propensity to consume is 50% and the proportional tax rate is 40%. What is the size of the multiplier? Round off your answer to two digits after the decimal

- [1] 1,00
[2] 1,32
[3] 1,43
[4] 2,50

$$\frac{1}{1 - 0,5(1 - 0,4)}$$

$$= \frac{1}{0,7} = 1,43 \rightarrow$$

[TURN OVER]

B20 Suppose sanctions are imposed on a small open economy which leads to a decrease in autonomous imports. What will happen to the aggregate expenditure curve if exports remain unchanged?

* Imports decrease

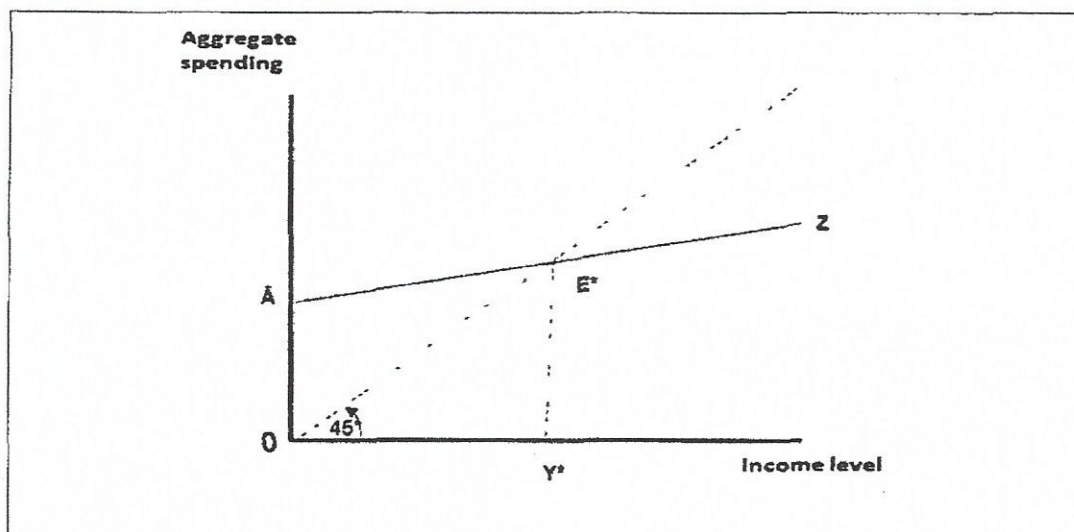
- [1] It will stay the same
- [2] It will shift upwards
- [3] It will shift downwards
- [4] The slope becomes flatter

B21 Which one of the following is incorrect with regard to an increase in proportional tax in the Keynesian model?

same effect
as decrease
in government
spending

- [1] It reduces the multiplier
- [2] It reduces the equilibrium income level, ceteris paribus
- [3] It leaves autonomous spending unchanged
- [4] It has the same effect as a decrease in government spending

Question B22 is based on the following diagram and the information provided below



Government spending = R500
Autonomous consumption = R200
Investment expenditure = R100
Marginal propensity to consume = 0,6
Proportional tax rate = 0,25

$$\begin{aligned} \alpha &= \frac{1}{1 - 0.6(1 - 0.25)} \\ &= \frac{1}{1 - 0.6(0.75)} \\ &= \frac{1}{1 - 0.45} \\ &= 1.82 \end{aligned}$$

$$Y = \alpha (\bar{A})$$

$$Y = 1.82(500 + 200 + 100) = 1456$$

[TURN OVER]

B22 What is the equilibrium level of income Y^* in the given model?

(Hint If you use the multiplier to calculate the equilibrium income level, round it off to three digits after the decimal Round the final answer off to the closest full rand)

- [1] R800
- [2] R1 273
- [3] R1 455
- [4] R2 667
- [5] R2 000

B23 A contractionary fiscal policy combined with an increase in the oil price will cause

- [1] a downward shift of the AS curve and a leftward shift of the AD curve
- [2] an upward shift of the AS curve and a rightward shift of the AD curve
- [3] a downward shift of the AS curve and a rightward shift of the AD curve
- [4] an upward shift of the AS curve and leftward shift of the AD curve

B24 Which one of the following statements is correct?

- [1] The Keynesian model can be used to study the impact of changes in monetary policy ✗
- [2] The AD-AS model can be used to study the impact of changes in the general level of wages on production, income, employment and inflation
- [3] Interest rates are given in the AD-AS model ✗
- [4] The interaction of aggregate supply and aggregate demand determines the level of economic activity in the Keynesian model ✗

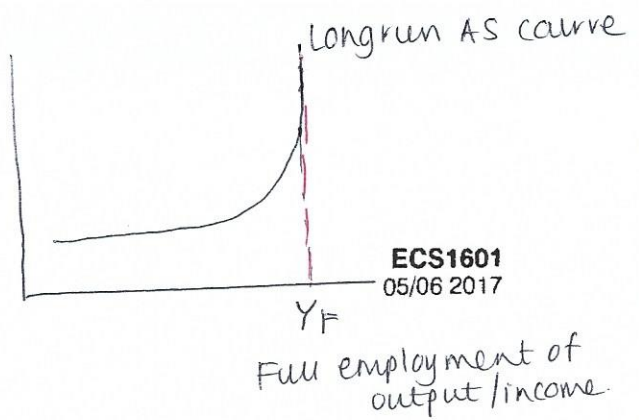
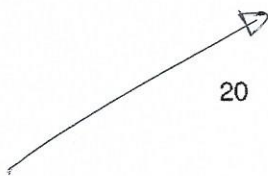
B25 Which of the following chain of events correctly represents the monetary transmission mechanism, assuming fixed prices?

- [1] $\uparrow i \rightarrow \downarrow I \rightarrow \downarrow A \rightarrow \downarrow Y$
- [2] $\downarrow i \rightarrow \downarrow I \rightarrow \downarrow A \rightarrow \downarrow Y$
- [3] $\uparrow i \rightarrow \downarrow I \rightarrow \uparrow A \rightarrow \downarrow Y$
- [4] $\downarrow i \rightarrow \uparrow I \rightarrow \uparrow A \rightarrow \downarrow Y$

B26 Which one of the following statements is correct?

- [1] Monetary and fiscal policies are collectively known as supply management policies
- [2] The lags associated with monetary and fiscal policy make these policies more effective
- [3] The implementation lag is shorter for monetary policy than for fiscal policy
- [4] In practice, fiscal and monetary policies are conducted independently of one another

[TURN OVER]



B27 Which of the following statements is correct?

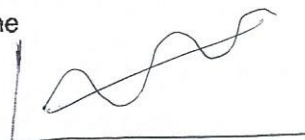
- [1] The AS curve is vertical at the level of full employment because the total available workforce is employed
- [2] Both cost-push and demand-pull inflation result in a lower level of total production and income
- [3] At the full employment level of total production and income, a contractionary fiscal policy will shift the AD curve to the right and cause inflation
- [4] If the profit margin is inflexible, higher wage demands can be inflationary

B28 Frank was laid off from his job because of a recession He is unemployed Susan works at a surf shop in Durban, but only for three months a year, for the rest of the year she is unemployed

- [1] structurally, seasonally X
- [2] cyclically, frictionally
- [3] structurally, frictionally X
- [4] cyclically, seasonally
- [5] cyclically, structurally

B29 Which one of the following statements is correct?

- [1] A recession is represented by the upswing section of the business cycle
- [2] All recessions last for the same amount of time and are identical in terms of severity
- [3] Upswings and downswings always last for the same period of time
- [4] Economic growth is not stable — Business cycle →



B30 Which one of the following statements is correct?

- [1] An increase in any one of the supply factors is sufficient to increase economic growth
- [2] South Africa primarily exports capital goods
- [3] Government spending can be raised indefinitely to increase economic growth
- [4] The export of minerals and metals helped the early South African economy to grow

[TURN OVER]