



**COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND  
GOVERNANCE**

**MEC 102: ECONOMIC PRINCIPLES 11 EXAM 1**

**END OF SECOND SEMESTER EXAMINATIONS**

**APRIL/MAY 2019**

**LECTURER: G Mandewo**

**DURATION: (3 HRS)**

on number 1 and any other THREE questions in this Question paper.

ow page in your answer Booklet. Credit will be awarded for logical, systematic and neat presentations

e in parenthesis.

calculator is permitted

**GE UNTIL YOU ARE TOLD TO BEGIN THE EXAM**

**Question 1**

(a) The following statistics are for the country called Zwana:

**Consumption function:  $C = 0.75Y_d$**

**Investment:  $I = 10\,000$**

**Government Spending:  $G = 6000$**

**Taxes:  $T = 0.15Y$**

**Disposable income:  $Y_d = Y - T$**

- i. How much does the government pay as transfer payments when income is zero? **[4 marks]**
  - ii. Calculate the tax and government multipliers for this economy
- (b) What is the difference between Gross Domestic Product (GDP) and Gross National Product (GNP) ? **[4 marks]**
  - (c) Use a practical example to demonstrate the problem of double counting and how it can be corrected. **[4 marks]**
  - (d) In the context of a two sector model what is the effect of introducing the Government Sector in the model? **[4 marks]**
  - (e) Stating your assumptions clearly deduce equilibrium income for a two sector model, three sector model and an open economy. **[20 marks]**
  - (f) What do you understand by term crowd out effect? **[4 marks]**

### **Question 2**

- (a) Explain in detail the following concepts
  - i. Leakages and injections**[4 marks]**
  - ii. Paradox of thrift**[4 marks]**
  - iii. Marginal propensity to save**[4 marks]**
  - iv. Open economy multiplier **[4 marks]**
  - v. Monetary base**[4 marks]**

### **Question 3**

- (a) You are given the following an Account for StanBic Bank. The required reserve is 15% and the initial deposit is US\$40 000
  - i. What the bank total credit creation? **[4 marks]**
  - ii. Suppose a depositor comes to the bank and withdraws \$5 000 in cash. What is the new total credit creation?**4 marks]**
- (b) Outline any 4 tools used by the Central Bank to increase or decrease money supply **[8 marks]**
- (c) In a speech that Senator Robert Kennedy gave when he was running for president in 1968, he said the following about GDP: [It] does not allow for the health of our children, the quality of their education, or the joy of their play. It does not include the beauty of our poetry or the strength of our marriages, the intelligence of our public debate or the integrity of our public officials. It measures neither our courage, nor our

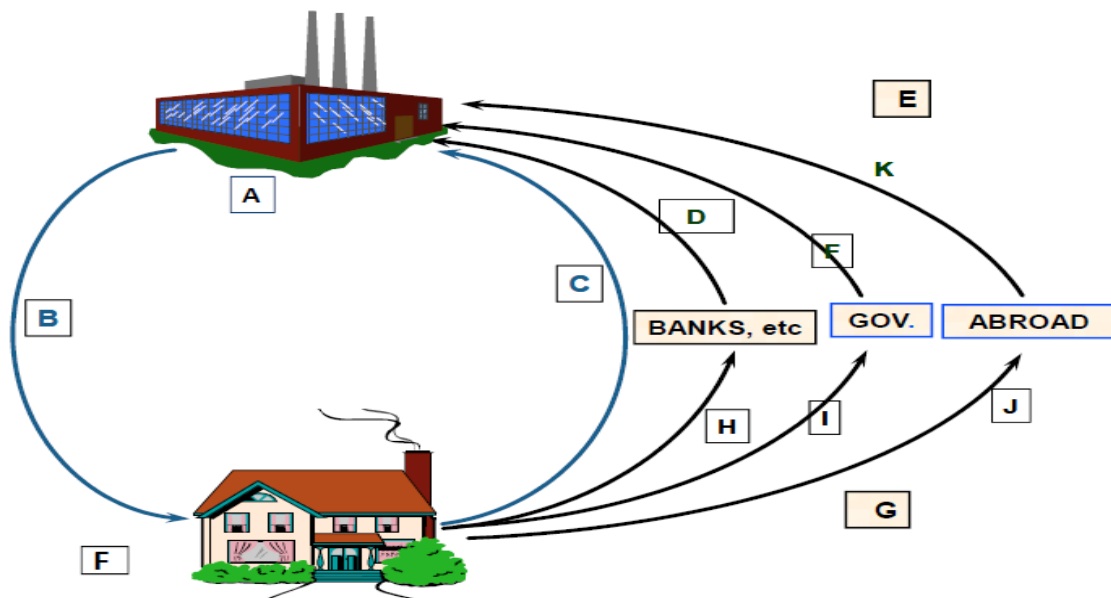
wisdom, nor our devotion to our country. It measures everything, in short, except that which makes life worthwhile, and it can tell us everything about America except why we are proud that we are Americans. Was Robert Kennedy right? If so, why do we care about GDP? [4 marks]

#### Question 4

- Discuss the different forms of unemployment [5 marks]
- Develop a two sector model of flow of national income (algebraically or otherwise) and deduce and justify the two equilibrium conditions. [5 marks]
- What is the difference between demand pull and cost push inflation? [5 marks]
- Using a relevant diagram illustrate the effect of money supply increases to the purchasing power of money and price level. [5 marks]

#### Question 5

- Explain what is meant by macroeconomics clearly explaining its concerns. What are the major components of the macro-economy [4 marks]
- What does the following diagram represent? Write down what is represented by each alphabet letter in the diagram [4 marks]



- Some countries have very high GDPs yet their people seem to be very poor. Briefly outline any six limitations of using GDP concept as a way of measuring the welfare of people in a country [8 marks]
- Describe the steps you would take to calculate the equilibrium level of GDP for this economy and calculate it ( $Y^e$ ). [4 marks]

### Question 6

- a. You have been give the following national statistics for Dream land, an island nation in the Caribbean

National Income Statistics for Dreamland (\$ 000s)	
GDP	6738.4
Receipts of factor income from rest of World	+167.1
Payments of factor income to rest of world	-178.6
Depreciation	-715.3
Indirect taxes minus subsidies	-553.1
Corporate profits minus dividends	-348.4
Social Insurance payments	-626.0
Personal interest income from gvt & consumers	+254.3
Transfer payments to persons	+963.4
Personal Taxes	-742.1

Using the information in the table, calculate the following statistics for Dreamland

- Gross National Product (GNP) [2 marks]
- Net National Product (NNP) [2 marks]
- National Income [2 marks]
- Personal Income [2 marks]

- b. FBC Bank has the following balance sheet as at 31 December 2014

Assets		Liabilities	
	\$		\$
Cash Reserves	110 000	Current Account Deposits	100 000
Property and Buildings	240000	Ordinary Shares	250000
<b>TOTAL</b>	<b>350 000</b>	<b>TOTAL</b>	<b>350000</b>

If the required reserve ratio is 20%, calculate the excess the excess reserves for FBC Bank. What is the money multiplier for this economy? If FBC was part of multiple bank system in the country and does not keep any excess reserves, what is the maximum amount of new current account deposits can be created by the banking system [4 marks]

- c. Suppose that the economy faces a recession and unemployment briefly explain how the Central Bank can use the following monetary policy instruments:

- i. Open market operations **[4 marks]**
- ii. Reserve Ratio **[4 marks]**

### **Question 7**

- a.** Suppose that creating a bicycle from scratch requires five different steps from five different firms. Firm A mines the raw metal from the earth and sells it to the metal refinery for \$90 and Firm B, the metal refinery, processes the metal it receives, purifying it and turning it into a metal that can be used for manufacturing purposes. Firm B sells the now processed metal to Firm C for \$150. Firm C turns the metal into a functioning bike before selling it to Firm D for \$400. Firm D distributes the bicycles to retailers at \$500 apiece. Firm E, the bike shop, then retails the bicycle to a consumer for \$700.
- (i)** Calculate the value added at each stage of this process and give the amount that will be included in the calculation of GDP **(5 marks)**
  - (ii)** Suggest methods for circumventing double counting **(5 marks)**
- b.** Briefly explain the 3 methods of calculating a country's GDP? **(5 marks)**
- c.** Briefly explain the three main determinants of money demand and illustrate with the arrow notation the effect of an expansionary fiscal policy on interest rates of the Central Bank does not accommodate the increase in money demand **(5 marks)**

**[END OF DOCUMENT]**