AFRICA UNIVERSITY
A United Methodist-Related Institution

"Investing in Africa's Future"

College of Business, Peace, Leadership and Governance

NMEC 102: ECONOMIC PRINCIPLES 2 EXAM

END OF FIRST SEMESTER EXAMINATIONS

APRIL/MAY 2020

LECTURER: R. MUDALA

DURATION:(48 HRS)

INSTRUCTIONS

Answer **ANY ONE question.** Total possible mark is **100.**

Start **each** question on a new page.

The marks allocated to **each** question are shown at the end of the question.

Show all your workings.

Credit will be awarded for logical, systematic and neat presentations.

Question 1

Case study: Greek economy

In 2010 the Greek government had to inform the European Commission on how it would control its budget deficit and improve the performance of its economy. The government's debt is so high that agencies assessing the creditworthiness of the government downgraded it (which would mean more interest has to be paid to raise finance). Proposals were likely to include a 10% cut in government spending.

a. Outline three possible economic objectives for the Greek government. **(20 Marks)**
b. Explain why the government's budget might be in a large deficit. **(20 Marks)**
c. What would the effect on aggregate demand be if the government cut public spending by 10%? (1**0 Marks)**
d. What actions can the government take to increase national income growth in Greece? **(10 Marks)**
e. If the Greek economy is in recession what would you expect to be the effect on:
   i) Inflation? **(5 Marks)**
   ii) Unemployment? **(5 Marks)**
   iii) Imports? **(5 Marks)**
f. Discuss how this situation leads to the crowding out effect. **(5 Marks)**
g. Occasionally, a government official will argue that a country should strive for both a trade surplus and a healthy inflow of capital from abroad. Explain why such a statement is economically impossible. **(20 Marks)**

Question 2

China targeting 8% growth in 2010

At the beginning of 2010 the Chinese government announced that it was targeting 8% growth for the economy again, despite the global recession. The target had been 8% for a number of years and the government had always met it. About 9% growth is expected in 2010 thanks to huge government fiscal and monetary stimulus measures. The Chinese economy is the third largest in the world. Forecasts for economic growth made by the International Monetary Fund for 2010 included China 9.2%, UK 0.9%, Japan 1.7%, USA 1.5% and India 6.4%. However, government officials in China recognized that growth was not guaranteed. China relies heavily on exports and so is vulnerable to economic change elsewhere in the world.

a. Why is economic growth often important to governments? **(5 Marks)**
b. 8% is relatively fast economic growth. Why does China set such as high target? **(5 Marks)**
c. Given the anticipated recession, why is China predicted to grow faster than many other economies? **(10 Marks)**
d. What types of fiscal and monetary stimulus might have been used to help the economy grow? **(25 Marks)**
e. Why does the reliance on exports make Chinese growth vulnerable to changes in other economies? **(25 Marks)**
f. Could the government make the economy less reliant on exports? **(10 Marks)**

Question 3

a. Last year, a small nation with abundant forests cut down \$200 worth of trees. It then turned \$100 worth of trees into \$150 worth of lumber. It used \$100 worth of that lumber to produce \$250 worth of bookshelves. Assuming the country produces no other outputs, and there are no other inputs used in producing trees, lumber, and bookshelves, what is this nation's GDP? **(10 Marks)**

b. Ethiopia has a GDP of \$8 billion (measured in U.S. dollars) and a population of 55 million. Costa Rica has a GDP of \$9 billion (measured in U.S. dollars) and a population of 4 million. Discuss what these numbers tell you about the standard of living for the two countries. **(10 Marks)**

c. What does GDP not tell us about the economy? **(5 Marks)**

d. Identify each of the following as involving either demand or supply. Draw a circular flow diagram and label the flows i through vi. (Some choices can be on both sides of the goods market.). Clearly explain the relationships

   i. Households in the labor market
   ii. Firms in the goods market
   iii. Firms in the financial market
   iv. Households in the goods market
   v. Firms in the labor market
   vi. Households in the financial market

   (40 Marks)

e. Cross country comparisons of GDP per capita typically use purchasing power parity(PPP) equivalent exchange rates, which are a measure of the long run equilibrium value of an exchange rate. Why could using market exchange rates, which sometimes change dramatically in a short period of time, be misleading? **(25 Marks)**

f. Who is the biggest winner in an inflationary environment? **(10 Marks)**

[END OF EXAM]