



“Investing in Africa’s Future”

College of Business, Peace, Leadership and Governance

MEC 102: ECONOMIC PRINCIPLES 11

END OF FIRST SEMESTER EXAMINATIONS

NOVEMBER 2019

LECTURER: G. MANDEWO

DURATION:(3 HRS)

INSTRUCTIONS

Answer **Question number 1** and **ANY** other three questions. Total possible mark is **100**.

Start **each** question on a new page in your answer booklet.

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.

SECTION A

1. (a) Stating your assumptions clearly deduce the equilibrium income for a
 - (i) Two-sector economy
 - (ii) Three sector economy
 - (iii) Four sector economy

In each of the above cases explain clearly factors that affect the production of goods and services **[12 Marks]**

(b) In the context of an open economy multiplier what is the effect of increasing the Marginal Propensity to import and why **[4 Marks]**

(c) What do you understand by the following terms? **[You may illustrate the concepts where possible]**

- (i) Paradox of thrifty **[4 Marks]**
 - (ii) Fallacy of composition **[4 Marks]**
 - (iii) Double counting error **[4 Marks]**
2. (a) Explain the equivalence of three methods of measuring GDP **[4 Marks]**
(b) State the four major components of the income approach of measuring GDP. **[4 Marks]**
(c) Considering the income approach why do we add taxes and subtract subsidies? **[4 Marks]**

SECTION B

3. (a) Stating your assumptions clearly deduce the multiplier for a two sector model and explain factors that affect production of goods and services **[4 Marks]**

(b) Explain the following concepts
 - (i) Income approach to calculation of GDP **[2 Marks]**
 - (ii) Depreciation **[2 Marks]**
 - (iii) Life cycle hypothesis **[8 Marks]**
(c) Differentiate between fiscal policy and monetary policy in the context of the ISLM model **[8 Marks]**
4. (a) Illustrate and explain the difference between inflationary and inflationary gap **[5 Marks]**

(b) Make a clear distinction between progressive tax and regressive tax **[5 Marks]**

(c) Distinguish between structural deficit and cyclical deficit **[5 Marks]**

(d) What options does a government have to finance budget deficit? **[5 Marks]**

5. (a) Write brief notes on

(i) Transaction demand for money **[3 Marks]**

(ii) Precautionary demand for money **[3 Marks]**

(iii) Speculative demand for money **[3 Marks]**

(b) What are the determinants of Money supply? **[5 Marks]**

(c) In what way does the quantity theory of money explain inflation? **[6 Marks]**

6. Explain and Illustrate in diagrams or algebra where possible the following concepts

(a) Liquidity trap **[4 Marks]**

(b) The crowd out phenomena **[4 Marks]**

(c) Investment Savings Curve **[4 Marks]**

(d) Open Market Operations **[4 Marks]**

(e) Inverse relationship between the price of bonds and interest rates **[4 Marks]**

7. (a) Derive the IS and LM curves from first principle **[5 Marks]**

(b) Suggest two factors that will result in a shift of each function and show it. **[5 Marks]**

(c) Demonstrate how monetary policy and fiscal policy may increase output in the context of the ISLM model. **[10 Marks]**

8. (a) Make a clear distinction between demand pull and cost push inflation. **[4 Marks]**

(b) Use the quantity theory of money to show that inflation is caused by too much money chasing too few goods. **[10 Marks]**

(c) Suggest practical measures to solve the problem of inflation. **[6 Marks]**

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