(A United Methodist-Related Institution)

"Investing in Africa's Future"

FACULTY OF MANAGEMENT AND ADMINISTRATION

COURSE TITLE: **MEC102 – ECONOMIC PRICIPLES II-PARALLEL**

SEMESTER 1: **FINAL EXAMINATION – NOV/DEC 2013**

LECTURER: **MR G MANDEWO**

TIME: **3 HOURS**

INSTRUCTIONS

Answer **All** questions in section A and any **TWO** questions in section B. 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 section.

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

SECTION A

1. 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) Paradox of thrift**[4 Marks]**
   (e) Open Market Operations**[4 Marks]**
   (f) Inverse relationship between the price of bonds and interest rates**[4 Marks]**

2. (a) A farmer grows a bushel of wheat and sells it to a miller for $1.00. The miller turns the wheat into flour and then sells the flour to a baker for $3.00. The baker uses the flour to make bread and sells the bread to an engineer for $6.00.The engineer eats the bread. Use two distinct methods to measure production for this particular activity? **[4 Marks]**

   (b) Consider an economy described by the following equations:
   $$Y = C + I + G,$$
   $$Y = 5000$$
   $$G = 1000$$
   $$T = 750$$
   $$C = 250 + 0.75(Y - T),$$
   $$I = 1,000 - 50r.$$

   i. In this economy, compute private saving, public saving, and national saving. **[4 Marks]**
   ii. Find the equilibrium interest rate. **[4 Marks]**
   iii. Now suppose that G rises to 1250. Compute private saving, public saving, and national saving. **[4 Marks]**
   iv. Find the new equilibrium interest rate. **[4 Marks]**
   v. Calculate the tax and government multipliers for this economy **[4 Marks]**
   vi. Make additional assumptions and derive equilibrium income for a four sector model. **[4 Marks]**

   (c) What is inflation tax? **[4 Marks]**

   (d) What are the lessons we infer from the life cycle hypothesis? **[4 Marks]**

SECTION B

4. (a) What insights do we draw from the life cycle hypothesis of consumption? **[10 Marks]**
   (b) Critically assess the absolute income hypothesis. **[10 Marks]**

5. (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]**

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

7. Write brief notes on
   (a) Measurement of unemployment **[5 Marks]**
   (b) Categories of unemployment **[5 Marks]**
   (c) Types of unemployment **[5 Marks]**
   (d) Policies meant o redress unemployment **[5 Marks]**

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