



FACULTY OF MANAGEMENT AND ADMINISTRATION

MEC 102: ECONOMIC PRINCIPLES 11

END OF FIRST SEMESTER EXAMINATIONS

APRIL/MAY 2017

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.

1. (a) Demonstrate the equivalence of the three methods of measuring national output. [4 Marks]
 - (b) Write brief notes on the following concepts
 - (i) Gross Domestic Product and Gross National Product[4 Marks]
 - (ii) Double counting error[4 Marks]
 - (c) There are two methods of resolving the double counting error. State and demonstrate how each resolves the problem. [4 Marks]
 - (d) Using the expenditure approach explicitly define each category of expenditure[4 Marks]
 - (e) What are the major components of National Income? [4 Marks]
 - (f) Why do we add indirect taxes and subtract subsidies? [4 Marks]
 - (g) Trace the changes you have to effect to move from GDP to National Income [4 Marks]
 - (h) Why is per capita income an accurate measure for social well being of a nation? [8 Marks]
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2. (a) Write brief notes on the following
 - (i) crowd-out effect[4 Marks]
 - (ii) Deduce the aggregate demand curve from the aggregate expenditures model[4 Marks]
 - (iii) Derive the IS curve [4 Marks]
 - (iv) What are the determinants of the aggregate demand curve? [4 Marks]
 - (b) In the context of the ISLM model effect contractionary fiscal policy. [4 Marks]
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3. (a) What are the functions of money? [4 Marks]
 - (b) Define the characteristics of money [4 Marks]
 - (c) How do banks create money? [4 Marks]
 - (d) Explain the functions of money. [4 Marks]

(e) State and explain the quantitative instruments of monetary policy. [4 Marks]

4. (a) Using the basic two sector model justify the two equilibrium conditions

- (i) Savings is equal Investments [4 Marks]
- (ii) Expenditures are equal to Income [4 Marks]

(b) Explain the effect of the adding the Government sector to a two sector model and the major changes it causes. [4 Marks]

(c) Given the following instruments of expansionary fiscal policy explain the transmission mechanism that increases consumer demand

- (i) cut in personal income tax [4 Marks]
- (ii) Cut in tax on interest from saving [4 Marks]

5. (a) Explain and Illustrate in diagrams or algebra where possible the following concepts

- i. Liquidity preference-Money Supply curve (LM curve) [4 Marks]
- ii. The crowd out phenomena [4 Marks]

(b) Suppose that the following equations describe an economy (C , I , G , T and Y measure in billions of dollars, r in percentage)

$$C = 170 + 0.8(Y - T)$$

$$T = 200$$

$$I = 100 - 4r$$

$$G = 350$$

$$(M/P)d = 0.75Y - 6r$$

$$M s/P = M/P = 735$$

Where G is Government expenditure, I is investment, T represents Taxes, C is consumption, Y stands for Income, r stands for interest rates, $(M/P)d$ is real money demand, $M s/P$ is real money supply,

(i) Derive both the IS and LM equations. [4 Marks]

(ii) Calculate the equilibrium levels of output Y , the interest rate r , planned investment I and consumption C . [4 Marks]

(iii) Suppose the government introduces a spending stimulus package (an increase in G) worth 36 billion dollars. Calculate the impact of this policy on the IS-LM curves and show these changes on a graph. [4 Marks]

5. (a) 'Hyperinflation occurs because governments want to increase spending but they ignore the fact that increasing the money supply will lead to inflation' Explain the theoretical basis that validates this statement. [5 Marks]

(b) Explain the causes of inflation [5 Marks]

(c) suggest solutions to the problem of inflation, demonstrating how each helps reduce inflation. [5 Marks]

(d) Contrast inflation to deflation [5 Marks]

6. The following has been cited as factors that affect investment

- (a) Interest rate [5 Marks]
- (b) Technological change [5 Marks]
- (c) Business Cycle [5 Marks]

Explain how each of the above influences an increase in investment.

(d) Why are capital investment low in developing countries such as Zimbabwe? [5 Marks]

7. (a) Diagrammatically derive the Investment-Savings (IS) curve. [5 Marks]
(b) Draw an ISLM model and mark one disequilibrium point. Explain the policy mix you will implement to foster equilibrium both in the goods and the money market. [5 Marks]
(c) In the context of the ISM model, explain how an expansionary fiscal policy will affect interest rate and income [5 Marks]
(d) In the ISLM model effect simultaneously contractionary fiscal policy and contractionary monetary policy [5 Marks]

8. Consider the following general version of the Keynesian cross:

$$Y = C + I + G$$

$$C = a + b(1 - t)Y$$

Where **I** is investment and **G** is government spending, both constant, **t** is the tax rate, **Y** is income, **C** is consumption and **a** and **b** are positive parameters.

- (a) Determine the multiplier and explain factors that affect production of goods and services in the multiplier. [5 Marks]
- (b) Expand the model to a four sector model of income determination and determine the multiplier. [5 Marks]
- (c) What are the factors that cause an increase in the multiplier in item (b)? [5 Marks]

8. Consider an economy with a labour force of 2.53 million workers, of which 2.3 million are employed.

- (a) Calculate the unemployment rate of this economy. [5 Marks]
- (b) Discuss and contrast different explanations for the existence of structural unemployment. [5 Marks]
- (a) Discuss frictional unemployment [5 Marks]
- (b) Suggest possible ways of reducing unemployment [5 Marks]

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