



*"Investing in Africa's future"*

**COLLEGE OF BUSINESS, PEACE, LEADERSHIP AND GOVERNANCE  
(CBPLG)**

**NMEC102 ECONOMIC PRINCIPLES 11**

**END OF SEMESTER PRE- EXAMINATION TEST**

**JULY 2022**

**LECTURER: MR T MASESE**

**DURATION: 3 HRS**

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**INSTRUCTIONS**

1. Section A is compulsory.
2. Candidates are to answer any THREE questions from section B
3. Marks will be awarded for clear, grammatically correct and well-constructed sentences



## **SECTION A**

1. Which one of the following is NOT a function of money?
  - A. Unit of account
  - B. Medium of exchange
  - C. Store of value
  - D. Means of barter
  - E. Standard of deferred payment
2. The value of national output produced by residents located within the country, before depreciation and including the influence of taxes and subsidies, is known as:
  - A. GDP at market prices
  - B. GDP at factor cost
  - C. GNP at market prices
  - D. GNP at factor cost
  - E. NNP at factor cost
3. A customer deposits \$500 in a bank. According to the 'credit multiplier' theory, if all banks have a reserve ratio of 20% then the amount of new deposits eventually created is:
  - A. \$250
  - B. \$1,600
  - C. \$2,500
  - D. \$1,500
  - E. \$400
4. If the Central Bank carries out an open market operation and sells government securities, it is likely that the interest rate:
  - A. falls and the quantity of money decreases
  - B. may rise or fall depending upon the state of the economy
  - C. rises and the quantity of money increases
  - D. falls and the quantity of money increases
  - E. rises and the quantity of money decreases.
5. Which *two* of the following is considered as broad measures money supply?
  - A. M0
  - B. M1
  - C. M2
  - D. M3
  - E. M4
6. The value of national output produced by residents of a country, whether located at home or overseas, after depreciation and excluding the influence of taxes and subsidies, is known as:
  - A. GDP at market prices
  - B. GDP at factor cost
  - C. GNP at market prices
  - D. GNP at factor cost
  - E. NNP at factor cost.



7. Which of the following terms is used to refer to purchases or sales of government bills and bonds?
- A. Precautionary demand for money
  - B. Quantity theory of money
  - C. Transactions demand for money
  - D. Money supply multiplier
  - E. Open market operations
8. Which *one* of the following items would be included in UK GDP?
- A. Payments made to unemployed workers during the year as part of their unemployment compensation.
  - B. The cost of the tools used by a car mechanic.
  - C. The cost of the pollution caused during the processing of steel during the year.
  - D. The purchase of stocks on the New York Exchange by a resident located in the US.
  - E. The purchase of stocks on the London Exchange by a UK resident located in the US.
9. The value of national income (output) can be expressed in a number of different ways. Try to match the *lettered* description with its correct *numbered* term **(5 marks)**

#### DESCRIPTIONS

- A. This measure takes into account the fact that some capital equipment will have depreciated over the year via wear and tear or because technological change has made it obsolescent.
- B. Value of output produced (and incomes received) by residents of that country wherever they are located.
- C. Measures of national output/income which *include* indirect taxes and subsidies.
- D. Measures of national output/income which *exclude* indirect taxes and subsidies.
- E. Value of output produced (and incomes received) by factors of production located within that country.

#### TERMS

- i. Gross domestic product (GDP)
- ii. Gross national product (GNP)
- iii. Net national product (NNP)
- iv. Market prices
- v. Factor cost



## **SECTION B**

### **Question 1**

- a. In measuring GDP from the expenditure side ( $GDP = C + I + G + NX$ ), which of the following expenditures are included and within which of the four categories? **(10 marks)**
- i. expenditures on cars by consumers
  - ii. expenditures on cars by firms
  - iii. expenditures on new machinery by Zimbabwean-owned forest companies in Zimbabwe
  - iv. expenditures on new machinery by SA-owned forest companies in Zimbabwe
  - v. reductions in business inventories
  - vi. purchases of second-hand cars and trucks
  - vii. the hiring of economic consultants by the Mutare City Council
- b. The list below provides some national income figures for the country of Econoland. All figures are in millions of dollars. Wages and salaries 5000, Interest income 200, Personal consumption 3900, Personal saving 1100, Personal income taxes 200, Business profits 465, Indirect taxes 175, Subsidies 30, Government purchases 1000, Exports 350, Imports 390, Net private investment 950, Depreciation 150.
- i. Using the expenditure approach, what is the value of GDP for Econoland? **(5 marks)**
  - ii. Using the income approach, what is the value of GDP? **(5 marks)**
  - iii. What is the value of net domestic income at factor cost? **(5 marks)**
- c. Jane the owner of the Great Cookie spends \$100 on eggs, \$50 on flour, \$45 on milk, \$10 on electricity and water and \$60 on wages to produce 200 great cookies. Cindy sells her cookie for \$1.50 each. Calculate the value added per cookie at the Great Cookie at each stage of production. How much is added to the GDP **(5 marks)**

### **Question 2**

- a. Define money multiplier, required and excess reserves. Suppose that a bank's customer deposits \$4000 in her current account at MBCA. The required reserve ratio is 0.25. What are the required reserves on this deposit? What is the largest loan that the bank can make on the basis of the new deposit? If the bank chooses to hold reserves of \$3000 on this new deposit, what are the excess reserves on the new deposit? **(5 marks)**
- b. Suppose when aggregate output equals zero, consumption equals \$100bn, autonomous investment equals \$200bn, government purchases equal \$50bn and net exports equals \$50bn. suppose also MPC is 0.9.



- i. Construct a table showing the level of aggregate expenditure, net exports and savings for aggregate output levels of 0, 200bn, 400bn, 500bn, 700bn, 900bn, 1000bn **(5 marks)**
  - ii. Calculate the equilibrium level of income **(3 marks)**
  - iii. What would be the new level of real GDP if an unfavorable change in exchange rates caused net exports to change by 50bn **(3 marks)**
- c. Autonomous consumption is the level of consumption that would occur if national income were zero. Since national income will never be zero, why do we talk about autonomous consumption? In other words what does it really mean? How does it affect the consumption schedule? What word might you use in place of *autonomous* when talking about autonomous consumption? **(4 marks)**
- d. After consumption the next major component of aggregate demand is investment. Briefly explain the main determinants of planned investment. What may cause the investment function to shift and what will cause a movement along the investment function? Why is the function less stable? **(10 marks)**

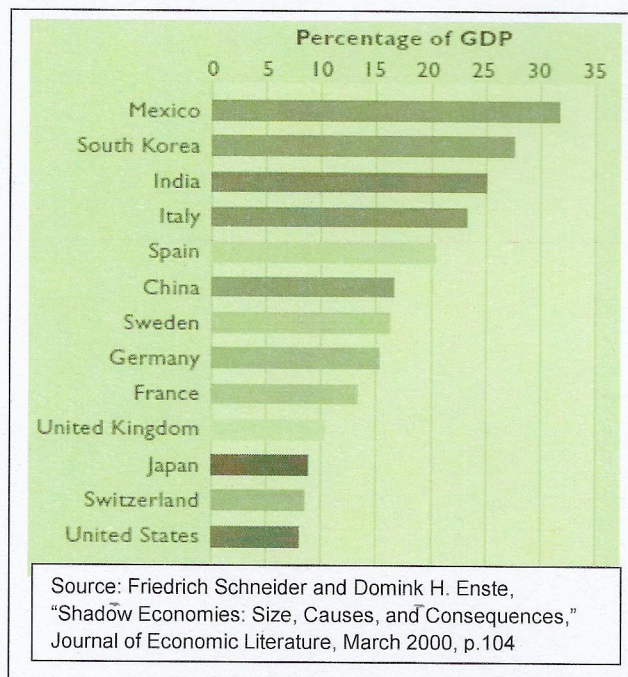
### Question 3

- a. Briefly explain the permanent income hypothesis **(4 marks)**
- a. Explain the round-by-round effect of the multiplier by using the circular flow diagram **(3 marks)**
- b. Distinguish between demand pull and cost push inflation. What are the government's fiscal policy options for ending severe demand-push inflation? What are the 5 major administrative constraints of fiscal policy **(10 marks)**
- c. In the economy of Lesotho, the marginal propensity to save is 0.1, investment is \$50bn, Government purchases of goods and services are \$40bn and lump-sum taxes are \$40bn. Lesotho has no exports or imports.
  - i. The government cuts its purchases of goods and services to \$30bn. What is the change in equilibrium expenditure **(2 marks)**
  - ii. What is the value of the government purchases multiplier **(2 marks)**
  - iii. The government continues to purchase \$40bn of goods and services and cuts lump-sum taxes to \$30bn. What is the change in equilibrium expenditure? **(3 marks)**
  - iv. What is the value of the lump-sum tax multiplier? **(2 marks)**
  - v. The government simultaneously cuts both its purchases of goods and services and lump-sum taxes to \$30bn. What is the change in equilibrium expenditure **(2 marks)**
  - vi. Explain why a given change in government spending has a greater impact on the economy than does the same change in taxation **(2 marks)**



### Question 6

Challenges are encountered in the efforts to use GDP as a measure of the standard of living due to factors like the size of the black or underground economy among others. Underground economies vary in size worldwide. Three factors that help explain the variation are (1) the extent and complexity of regulation, (2) the type and degree of taxation, and (3) the effectiveness of law enforcement. The following diagram shows the level of the black or underground economy in a number of countries as a percentage of GDP.



- What is meant by the black or underground economy? How do economists try to estimate the size of the black economy? (10 marks)
- Discuss the other weaknesses encountered in the use GDP as a measure of living standards over time and as a comparison tool for living standards in different nations (20 marks)

**END OF PAPER**