

**UNIVERSITY OF SWAZILAND**  
**DEPARTMENT OF ECONOMICS**  
**FINAL EXAMINATION MAY 2013**

**PAPER TITLE : PRINCIPLES OF MACROECONOMICS**  
**COURSE CODE : ECON 104**

**INSTRUCTIONS:**

- 1. THIS PAPER HAS TWO SECTIONS A AND B**
- 2. ANSWER ALL MULTIPLE CHOICE QUESTIONS IN SECTION A**
- 3. ANSWER ANY TWO QUESTIONS IN SECTION B.**
- 4. TIME ALLOWED IS THREE (3) HOURS**

**THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.**

## **PART A - MULTIPLE QUESTIONS**

(a) Circle only one best answer for the question

(b) An attempt to circle **two answers** on one question is zero

1. A politician proposes reducing business taxes, a move she says will encourage risk-taking entrepreneurship. This proposed cut in business taxes is intended to stimulate the economy mainly through
  - A. an increase in aggregate supply.
  - B. a decrease in aggregate supply.
  - C. a decrease in aggregate demand.
  - D. an increase in aggregate demand.
  
2. One country enjoys a comparative advantage over another in producing oil when
  - A. it has more oil than the other country.
  - B. it can produce oil at a lower opportunity cost than the other country.
  - C. it does not need to import oil.
  - D. it wants to export as much oil as possible.
  
3. Drought conditions create water shortages. Assuming that water consumption can be measured for each household, select the water policy below that is most likely to cause the greatest reduction in water use by urban households.
  - A. Give water to users with instructions to use it wisely.
  - B. Charge a flat (constant) fee of \$50 per household, irrespective of the amount of water used.
  - C. Raise the price of water from 2 cents to 50 cents per gallon with the biggest water users (per capita) paying the highest price per gallon.
  - D. Charge \$20 per month and limit household consumption to last year's monthly
  
4. The basic difference between macroeconomics and microeconomics is that
  - A. macroeconomics looks at the forest (aggregate markets), while microeconomics is concerned with the individual trees (subcomponents)
  - B. macroeconomics is concerned with policy decisions, while microeconomics applies only to theory.
  - C. microeconomics is concerned with the forest (aggregate markets), while macroeconomics is concerned with the trees (components).
  - D. opportunity cost is applicable to macroeconomics, and the fallacy of composition relates to microeconomics.
  
5. Adam Smith believed that if people were free to pursue their own interests, then
  - A. greed and cheating would prevail in the market.
  - B. less would be produced than if altruism were our guiding principle.
  - C. they would generally be encouraged to produce goods and services that others valued highly (relative to their costs).
  - D. the public interest would be best served, but the interests of employers would be hurt.
  
6. Which of the following is most likely to benefit a debtor?
  - A. unanticipated deflation
  - B. anticipated deflation
  - C. unanticipated inflation
  - D. anticipated inflation

For the following question, choose the word to complete the sentence that most accurately reflects the relationship, definition, or similarity of the first pair of words in the sentence:

7. Parts are to the whole as C+I+G+X is to.....
- A. trade surplus
  - B. gross domestic product
  - C. disposable income
  - D. aggregate supply
  - E.
8. The primary benefit that results when a nation employs its resources in accordance with the principle of comparative advantage is
- a. an expansion in capital investment resulting from a reallocation of resources away from consumption.
  - b. a larger output resulting from a more efficient use of resources
  - c. greater equality of income resulting from an increase in the number of workers.
  - d. an increase in the profitability of business enterprises resulting from an increase in capital formation.
9. When the Federal Reserve Bank lowers the reserve requirement
- a. investors will purchase "open market" bonds.
  - b. banks must hold less money.
  - c. people will deposit more money.
  - d. banks will create more money.
10. The price of an airline ticket from Denver to Washington, D.C., is \$600. A bus ticket is \$150. Traveling by plane takes six hours, compared with 36 hours by bus. Other things constant, an individual would gain by choosing air travel if, and only if, his time were valued at more than
- a. \$6 per hour.
  - b. \$8 per hour.
  - c. \$10 per hour.
  - d. \$15 per hour.
11. Does voluntary exchange create wealth (value)?
- a. No, exchange does not expand output.
  - b. No, if one person gains, the other party must lose an equal amount.
  - c. Uncertain, it does when it results in the creation of additional goods and services; otherwise it does not.
  - d. Yes, trade generally permits the trading partners to gain more of what they value; this is why they agree to the terms of the exchange.
12. (I) A tornado strikes Michigan, destroying most of the automobile manufacturing plants, and reducing the supply of automobiles.
- (II) For the fourth year in a row, the inflation rate is 3 percent.
- a. I is most likely an unanticipated change; II is most likely an anticipated change.
  - b. I is most likely an anticipated change; II is most likely an unanticipated change.
  - c. Both I and II are most likely unanticipated changes.
  - d. Both I and II are most likely anticipated changes.
13. Which of the following will most likely accompany an unanticipated increase in aggregate demand?
- a. an increase in prices
  - b. an increase in unemployment
  - c. a decrease in real GDP
  - d. a decrease in the demand for resources

14. In the aggregate demand/aggregate supply model, when the output of an economy is less than its long-run potential, the economy will experience
- falling real wages and resource prices that will stimulate employment and real output.
  - rising interest rates that will stimulate aggregate demand and restore full employment.
  - a budget surplus that will stimulate demand and, thereby, help restore full employment.
  - using resource prices that will restore equilibrium at a higher price level.
15. Which of the following will most likely result from an unanticipated decrease in aggregate supply due to unfavorable weather conditions in agricultural areas?
- a decrease in inflation
  - a decrease in unemployment
  - an increase in prices
  - an increase in the natural rate of unemployment
16. Which of the following will most likely increase aggregate supply in the long run?
- unfavorable weather conditions in agricultural areas
  - an increase in the expected inflation rate
  - higher real interest rates
  - a high rate of capital investment, which expands the future supply of productive resources
17. Within the AD/AS model, an unanticipated increase in short-run aggregate supply will cause real output to
- increase and prices to decrease.
  - decrease and prices to increase.
  - increase and prices to increase.
  - decrease and prices to decrease.
18. An increase in the long-run aggregate supply curve indicates that
- potential real GDP has increased.
  - unemployment has increased.
  - employment has increased.
  - the natural rate of unemployment has increased.
19. Which of the following will most likely accompany an unanticipated decrease in aggregate demand?
- an increase in the general price level or inflation
  - a decrease in resource prices
  - an increase in real GDP
  - a decrease in unemployment
20. Which of the following statements is most consistent with the view that the economy has a self-corrective mechanism?
- When the economy is in a recession, it will remain there until the government steps in to bring the economy out of the recession.
  - When the economy is in a recession, falling resource prices will eventually increase short-run aggregate supply, bringing the economy back to full employment.
  - During economic booms, interest rates will fall, causing the economy to fall into a recession.
  - In a market economy, resource prices, such as wages, can only increase; they can never decrease.
21. A decline in the real interest rate in the loanable funds market will cause the
- aggregate demand curve to shift to the right.
  - aggregate demand curve to shift to the left.
  - long-run aggregate supply curve to shift to the left.

- d. natural rate of unemployment to fall.
22. In a single year, a \$5 billion tax reduction was accompanied by a \$9 billion increase in consumer spending. From a Keynesian view, the most probable explanation for the increase in consumer spending by more than the amount of the tax cut is that
- lower taxes caused government spending to fall, which led to the increase in consumer spending.
  - increased consumption spending by those with higher disposable incomes led to higher incomes and still more consumption spending by others.
  - the tax cut caused interest rates to fall, thus increasing consumer spending.
  - the lower taxes prompted the Federal Reserve to sell U.S. securities, causing both the money supply and consumer spending to increase.
23. Although the economy was in the Great Depression, the Hoover administration followed a fiscal policy of balancing the budget. A Keynesian would have found this policy
- inappropriate because it probably would have depressed economic activity and led to further increases in unemployment.
  - appropriate because it probably would have led to a significant increase in the money supply and thereby increased employment.
  - inappropriate because it probably would have impaired the ability of monetary policy to end the Depression.
  - appropriate because it probably would have stimulated economic activity and helped end the Depression.
24. Suppose U.S. policy makers decide that to stimulate GDP growth, investment must be increased. What is needed, they conclude, is a reallocation of resources away from producing consumer goods and toward producing capital goods. Which of the following policy alternatives would most likely accomplish this objective?
- a reduction in personal income taxes
  - a reduction in state sales taxes
  - a tax credit allowance for business investment in capital equipment
  - restrictive monetary policy
25. According to the Keynesian view, which of the following would most likely decrease aggregate demand?
- a decrease in tax rates
  - a decrease in government expenditures
  - an increase in transfer payments
  - an increase in the budget deficit
26. Which of the following is an example of an automatic stabilizer?
- Congress legislates lower tax rates to increase consumption and investment.
  - Tax rates are increased during a recession to maintain a balanced budget.
  - A regressive income tax system reduces tax revenues (as a share of income) as income expands.
  - Revenues from the corporate income tax increase sharply during a business boom but decline substantially during a recession, even though no new tax legislation is enacted.
27. Keynesian analysis implies that a planned budget deficit is
- always necessary to ensure full employment.
  - proper during slack economic conditions but highly inappropriate if the economy is already operating at capacity.
  - of little consequence unless there is a corresponding change in the money supply.
  - an effective method of dealing with inflation.

28. The crowding-out effect suggests that
- expansionary fiscal policy causes inflation.
  - restrictive fiscal policy is an effective weapon against inflation.
  - reduction in private spending resulting from the higher interest rates caused by a budget deficit will largely offset the expansionary impact of a pure fiscal action.
  - a budget surplus will cause the private demand for loanable funds, the interest rate, and aggregate demand to fall.
29. Other things constant, an increase in marginal tax rates will:
- decrease the supply of labor and reduce its productive efficiency.
  - decrease the supply of capital and reduce its productive efficiency.
  - encourage individuals to substitute less desired, tax-deductible goods for more desired, non-deductible goods.
  - cause all of the above.
30. The new classical model implies that substitution of debt for tax financing
- increases aggregate demand and exerts a multiplier effect leading to an expansion in real output.
  - is highly effective against inflation.
  - reduces consumption because it increases both the current and future tax liability of households.
  - leaves wealth and therefore aggregate demand unchanged since the debt implies higher future taxes.
31. A balanced budget is present when
- the economy is at full employment.
  - the actual level of aggregate spending equals the planned level of spending.
  - public sector spending equals private sector spending.
  - government revenues equal expenditures.
32. If the required reserve ratio is 10 percent, a bank with a new deposit of \$1,000
- must keep \$100 on reserve and can make up to \$900 in new loans.
  - must keep \$200 on reserve and can make up to \$800 in new loans.
  - must keep \$900 on reserve and can make up to \$100 in new loans.
  - must keep \$1,000 on reserve and can make no additional loans.
33. Which one of the following is incorrect regarding money?
- Money is a medium of exchange.
  - Money is a store of value.
  - Money serves as a unit of account.
  - The value of money is dependent on the quantity of gold held by the Federal Reserve.
34. Which of the following are changes altering the nature of money and the usefulness of the money supply figures?
- the widespread holding of U.S. currency outside the country by foreigners
  - the increasing availability of stock and bond mutual funds
  - the use of debit cards and electronic money
  - all of the above
35. Which of the following is primarily responsible for controlling the money supply in the United States?
- the U.S. Congress
  - the Council of Economic Advisors
  - the U.S. Treasury
  - the Board of Governors of the Federal Reserve System

36. If the Fed wanted to use all three of its major monetary control tools to decrease the money supply, it would
- buy bonds, reduce the discount rate, and reduce reserve requirements.
  - sell bonds, reduce the discount rate, and reduce reserve requirements.
  - sell bonds, reduce the discount rate, and increase reserve requirements.
  - sell bonds, increase the discount rate, and increase reserve requirements.
37. If a decrease in the money supply were desired to slow inflation, the Federal Reserve might
- increase the reserve requirements.
  - sell U.S. securities on the open market.
  - raise the discount rate.
  - buy U.S. securities directly from the Treasury.
38. The Federal Reserve's most frequently used monetary tool is
- the discount rate.
  - the reserve requirements.
  - moral persuasion.
  - open market operations.
39. Suppose the Fed purchases \$100 million of U.S. securities from the public. The reserve requirement is 20 percent and all banks have zero excess reserves. The total impact of this action on the money supply will be a
- \$100 million decrease in the money supply.
  - \$100 million increase in the money supply.
  - \$200 million increase in the money supply.
  - \$500 million increase in the money supply.
40. A reserve requirement of 20 percent implies a potential money deposit multiplier of
- 4%.
  - 5%.
  - 20%.
  - 25%.
41. A bank receives a demand deposit of \$1,000. The bank loans out \$600 of this deposit and increases its excess reserves by \$300. What is the legal reserve requirement?
- 10 percent
  - 20 percent
  - 60 percent
  - 70 percent
42. Economists use the term "business cycle" to refer to
- the growth of small businesses into major corporations.
  - changes in products that occur from improved technology.
  - fluctuations in economic activity, measured by GDP or unemployment.
  - periods of increases and decreases in the rate of inflation.
43. Suppose there was a country with a population of 1000, of which 200 were unemployed and 500 were employed. Which of the following is true?
- The numbers have been calculated incorrectly as there are 300 people who are neither employed nor unemployed.
  - The labor force participation rate is 50 percent.

- c. The unemployment rate is 20 percent.
  - d. There are 700 individuals in this country's labor force.
44. The type of unemployment caused by changes in the business cycle is
- a. structural unemployment.
  - b. natural unemployment.
  - c. frictional unemployment.
  - d. cyclical unemployment.
45. An individual should continue to spend time searching for a job as long as
- a. all salary offers are below what the person expected.
  - b. the marginal gain from additional search exceeds the marginal cost.
  - c. job openings are available in the individual's field.
  - d. information is available that the individual has not yet collected.
46. Suppose an economy is operating at its maximum sustainable output rate. It is not in a recession, but neither is it experiencing a boom. Which of the following would be true?
- a. The economy would be considered at full employment.
  - b. Actual GDP would equal potential GDP.
  - c. Actual unemployment would equal the natural rate of unemployment.
  - d. All of the above are true.
47. Which of the following persons would be considered unemployed by the official government definition?
- a. George, a mathematician who returned to graduate school after failing to find a job the last four months
  - b. Gwen, a medical student, who is still in college and is not working
  - c. Morgan, who is employed part-time but desires a full-time job
  - d. Ralph, an auto worker vacationing in Manzini during a layoff at a General Motors plant due to an annual change-over in models
48. During a recession, which of the following will be true?
- a. The actual rate of unemployment will be lower than the natural rate.
  - b. Actual GDP will be lower than potential GDP.
  - c. Actual employment will exceed what is considered full employment.
  - d. Actual inflation will be higher than was anticipated.
49. Which of the following is not a harmful effect of inflation?
- a. Unanticipated inflation increases the risk associated with long-term contracts.
  - b. Inflation distorts the information delivered by market prices.
  - c. Individuals will waste productive resources protecting themselves from the effects of inflation.
  - d. Inflation increases the purchasing power of the lilangeni.
50. Which of the following is a correct statement?
- a. Fiscal policy is the use of tax and spending policies by the government
  - b. Fiscal policy involves the control of the money supply by RBS.
  - c. Monetary policy involves the control of the money supply by the government.
  - d. Monetary policy is the use of tax and spending policies by RBS.

## SECTION B: ESSAY QUESTIONS

[Total marks = 50]

### QUESTION 1

[25]

With the aid of diagrams discuss the Classical and Keynesian unemployment and state their causes.

### QUESTION 2

[25]

- A. Briefly explain three limitations of GDP when it used as a measure of the welfare of an economy (9)
- B. Distinguish between:
- (i) Transactions money and speculative money demand (4)
  - (ii) Income approach and output approach (6)
- C. What is an economic model? State two reasons for the use of models in economics (6)

### QUESTION 3

[25]

- A. Distinguish between the following:
- (i) Income payments and transfer payments (5)
  - (ii) Nominal GDP and real GDP (5)
- B. What is a circular flow diagram? (5)
- C. With the aid of diagrams, carefully distinguish between cost push inflation and demand pull Inflation (10)