ASSIGNMENT 1ST SEMESTER : MACROECONOMICS (MAC) ECONOMICS 1 (ECO101)

STUDY UNITS COVERED : STUDY UNITS 1 AND 2

DUE DATE : 3:00 p.m. 19 MARCH 2013

TOTAL MARKS : 100

INSTRUCTIONS TO CANDIDATES FOR COMPLETING AND SUBMITTING ASSIGNMENTS

The complete ‘Instructions to Students for Completing and Submitting Assignments’ must be collected from any IMM GSM office, the relevant Student Support Centre or can be downloaded from the IMM GSM website. It is essential that the complete instructions be studied prior to commencing your assignment. The following points highlight only a few important notes.

1. You are required to submit ONE assignment per subject.

2. The assignment will contribute 20% towards the final examination mark, and the other 80% will be contributed by the examination, however, the examination papers will count out of 100%.

3. Although your assignment will contribute towards your final examination mark, you do not have to earn credits for admission to the examinations; you are automatically accepted on registering for the exam.

4. Number all the pages of your assignment (e.g. page 1 of 4) and write your name and surname, student number and subject at the top of each page.

5. The IMM GSM requires assignments to be presented in a typed format, on plain A4 paper. Unless otherwise specified, this assignment must be completed within a limit of 1500 words, excluding the bibliography. Students who exceed the word limit may find that only part of the submitted assignment will be marked.

6. A separate assignment cover, which is provided by the IMM GSM, must be attached to the front of each assignment.

7. Retain a copy of each assignment before submitting, in case the original does not reach the IMM GSM.

8. The assignment due date refers to the day up to which assignments will be accepted for marking purposes. The deadline is 3:00 p.m. on 19 March 2013. Late assignments will be accepted, but 25 marks will be deducted from the maximum mark, if received after 3:00 p.m. on 19 March 2013 and up to 5:00 p.m. the following day, after which no assignments will be accepted.

9. If you fail to follow these instructions carefully, the IMM Graduate School of Marketing cannot accept responsibility for the return of the assignment. It may even result in your assignment not being marked.

Results will be available on the IMM GSM website, www.immgsm.ac.za, on Friday, 3 May 2013.
QUESTION 1 [50]

MULTIPLE-CHOICE

1.1 The two major types of market in the simple circular flow of income and expenditure are

a. public markets and private markets.
b. free markets and regulated markets.
c. factor markets and foreign exchange markets.
d. goods markets and services markets.
e. goods markets and factor markets.

1.2 Which of the following statements is incorrect?

a. The three major flows in the economy are total production, total income and total spending.
b. There are two sets of markets in a simple economy: goods markets and factor markets.
c. In the simple circular flow of economic activity, ‘real’ flows of goods and factors, and financial flows move in opposite directions.
d. Firms are buyers in goods markets and sellers in factor markets, while households are buyers in factor markets and sellers in goods markets.
e. Firms are the largest purchasers of capital goods.

1.3 In the simple circular flow of economic activity, goods and services flow via

a. factor markets to goods markets.
b. factor markets from households to firms.
c. goods markets from households to firms.
d. factor markets from households to firms.
e. goods markets from firms to households.

1.4 In the circular flow of economic activity, ________ households in ________ markets represents ________ firms. Taxes and imports represent ________ the circular flow.

a. expenditure by; goods; income to; injections into
b. expenditure by; factor; income to; withdrawals from
c. income to; factor; expenditure by; withdrawals from
d. income to; goods; expenditure by; injections into
e. expenditure by; factor; income to; injections into
1.5 In the circular flow of income and spending in South Africa, ________ firms in the factor market becomes ________ households, while ________ households in the goods market becomes ________ firms. Expenditure by foreigners on South African products constitutes ________ the circular flow.

a. income to; spending by; income to; spending by; a leakage from
b. income to; income to; spending by; spending by; an injection into
c. spending by; income to; spending by; income to; an injection into
d. spending by; spending by; income to; income to; a leakage from
e. production of; spending by; production of; income to; a leakage from

1.6 In the context of the circular flow of economic activity, which of the following would not be a traditional activity of the government?

a. Purchases of labour services from households
b. Purchases of capital goods from firms in goods markets
c. Provision of public goods and services
d. Transfers of tax revenues to low-income groups or regions
e. Sales of consumer goods to foreign buyers

1.7 Which of the following does not represent a key macroeconomic variable?

a. The unemployment rate
b. The inflation rate
c. Gross Domestic Product (GDP)
d. Income distribution
e. The population growth rate

1.8 If we were to add up the value of output of all firms in the economy, we would

a. obtain GDP at factor cost.
b. obtain GDP at market prices.
c. obtain GDP using the income method.
d. overestimate the value of production taking place in the economy.
e. underestimate the value of production taking place in the economy.

1.9 To obtain GDP at market prices from gross domestic expenditure, we must

a. subtract spending on exports and add spending on imports.
b. subtract spending on imports and add spending on exports.
c. subtract spending on intermediate goods and add spending on exports.
d. subtract spending on exports and add spending on intermediate goods.
e. subtract spending on net exports.
1.10 The inflation rate is measured by

a. the ratio of current year CPI to base year CPI.
b. the percentage change in the CPI from one year to the next.
c. the percentage change in GDP from one year to the next.
d. the ratio of current year CPI to the next year’s CPI.
e. the ratio of current year PPI to the next year’s PPI.

1.11 The current account of the balance of payments records

a. all sales and purchases of goods and services as well as income flows to and from the rest of the world.
b. the value of exports, but not imports.
c. the change in the country’s gold and foreign exchange reserves.
d. all purely financial flows in and out of the country.
e. All of the above.

1.12 If the financial (or capital) account is in surplus, then

a. the value of imports exceeds the value of exports.
b. the value of exports exceeds the value of imports.
c. there will be a surplus on the overall balance of payments.
d. capital outflows exceed capital inflows.
e. there has been a net inflow of foreign capital into the country.

1.13 Which one of the following steps is required to construct a Lorenz curve?

a. Find the cumulative age of the population.
b. Order the population from youngest to oldest.
c. Order the population from poorest to richest.
d. Divide the income of the richest group by the income of the poorest group.
e. Divide the population into ten equal groups and calculate the average income of these groups.

1.14 Money overcomes the problem of a double coincidence of wants inherent in the barter system through its function as a

a. medium of exchange.
b. unit of account.
c. standard of deferred payment.
d. store of value.
e. financial intermediary.

1.15 If banks lend their excess reserves, the immediate effect will be that

a. the money supply will remain unchanged.
b. interest rates will rise.
c. money will be created.
d. the price level will fall.
e. money demand will fall.
1.16 If the cash reserve requirement of the banking system is 20% and banks hold no excess reserves, then the value of the credit multiplier will be

a. 0.
b. 0.2.
c. 5.
d. less than 5.
e. greater than 5.

1.17 The _______ demand for money arises out of the need to hold money as a medium of exchange. This demand for money is a function of _______.

a. precautionary; interest rates
b. transactions; national income
c. speculative; interest rates
d. precautionary; national income
e. transactions; interest rates

1.18 If the central bank sells government securities in the open market, the supply curve of money will shift to the

a. left, and the interest rate will rise.
b. left, and the interest rate will fall.
c. right, and the interest rate will rise.
d. right, and the interest rate will fall.
e. right, and the interest rate will remain unchanged.

1.19 An increase in the interest rate

a. will shift the money demand curve downwards.
b. implies a lower opportunity cost of holding money balances.
c. will cause the price of bonds to fall.
d. could be the result of an open market purchase of securities.
e. will increase the purchasing power of money.

1.20 A decrease in the rate of interest

a. lowers the opportunity cost of money and leads to an increase in the quantity of money demanded.
b. raises the opportunity cost of money and leads to an increase in the quantity of money demanded.
c. lowers the opportunity cost of money and leads to a decrease in the quantity of money demanded.
d. raises the opportunity cost of money and leads to a decrease in the quantity of money demanded.
e. does not affect the quantity of money demanded.
1.21 Money market equilibrium occurs
   a. when interest rates are fixed.
   b. when the level of real GDP is constant.
   c. when the quantity of money demanded equals the quantity of money supplied.
   d. when contractionary monetary policy is used.
   e. when lending is discouraged.

1.22 If initially there existed an excess supply of money in the economy, equilibrium in the money market would be restored through
   a. individuals buying bonds, causing the price of bonds to rise and the interest rate to fall.
   b. individuals selling bonds, causing the price of bonds to fall and the interest rate to rise.
   c. individuals selling bonds, causing the price of bonds to rise and the interest rate to fall.
   d. individuals buying bonds, causing the price of bonds to fall and the interest rate to rise.
   e. None of the above.

1.23 Which of the following would cause a decrease in the supply of money?
   a. An increase in the rate at which the central bank lends to commercial banks
   b. A reduction in the reserve requirement
   c. Purchase of government securities by the central bank
   d. A reduction in the income tax rate
   e. None of the above

1.24 If government spending is higher than current government revenue, this is known as
   a. a deficit on the current account of the balance of payments.
   b. the budget deficit.
   c. the public debt.
   d. money financing.
   e. good fiscal management.

1.25 The South African income tax system is
   a. regressive.
   b. a flat-rate tax.
   c. proportional.
   d. progressive.
   e. indirect.
1.26 A tax such as VAT would generally be viewed as

a. progressive, because the consumption expenditure of the rich is greater than that of the poor.
b. regressive, because low-income households spend a greater proportion of their income on goods that attract VAT.
c. proportional, because the VAT rate is constant across goods that attract VAT.
d. progressive, because most goods consumed by poor households are zero rated.
e. regressive, because the VAT burden increases as household income rises.

1.27 Which of the following would be classed as an expansionary fiscal policy?

a. An increase in the money supply
b. A reduction in the number of goods exempted from VAT
c. An increase in government taxation
d. An increase in government expenditure
e. An increase in the VAT rate

1.28 If the price elasticity of supply of cell phones in a country is +0.8, whilst the price elasticity of demand is –1.7, then a specific tax placed on cell phones will be borne

a. more by producers than by consumers.
b. about equally by producers and consumers.
c. more by consumers than by producers.
d. by the government.
e. None of the above statements are correct.

1.29 South Africa has a comparative (relative) advantage over France in the production of maize if it

a. produces maize with fewer material inputs than France.
b. can match France’s output of maize and have resources left over.
c. can produce maize with the same resources as France but faster.
d. has an absolute advantage over France.
e. produces maize at a lower opportunity cost than France.

1.30 Australia has an absolute advantage over South Africa in wool production if, during a year, Australia

a. can produce more wool than South Africa.
b. specialises in wool production.
c. can produce less wool than South Africa.
d. can produce more wool than South Africa with a given amount of resources.
e. consumes more wool than South Africa on average.
1.31 If two countries have differing opportunity costs of production for two goods, then

a. each country should specialise in the good for which it has a higher opportunity cost of production.
b. only the country with an absolute advantage in the production of both goods stands to gain from trade.
c. each country should purchase inputs from the other country in order to gain an absolute advantage.
d. each country should specialise in the production of the good for which it has a relative advantage.
e. each country should import all goods instead of producing them domestically.

Consider the case of two countries, Afghanistan and the US, both producing carpets and fighter aircraft. The table below shows output rates per day in the two countries if all resources are fully and efficiently employed. Use this information to answer Questions 32, 33 and 34.

<table>
<thead>
<tr>
<th>Carpets</th>
<th>Fighter aircraft</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan</td>
<td>100</td>
</tr>
<tr>
<td>US</td>
<td>500</td>
</tr>
</tbody>
</table>

1.32 Based on this information,

a. there is no opportunity for mutually beneficial trade between the two countries.
b. Afghanistan has an absolute advantage in the production of both goods.
c. Afghanistan should import carpets from the US.
d. Afghanistan has a comparative advantage in the production of aircraft.
e. the US should export fighter aircraft to Afghanistan.

1.33 An appropriate international exchange ratio that would allow mutually advantageous trade to take place would be

a. 1 aircraft = 25 carpets.
b. 1 aircraft = 20 carpets.
c. 1 carpet = 4 aircraft.
d. 1 carpet = 0.04 aircraft.
e. 1 aircraft = 22 carpets.

1.34 If Afghanistan raised its aircraft productivity to 5 units per day, then

a. mutually beneficial trade would no longer be possible.
b. Afghanistan would continue to import fighter aircraft from the US.
c. Afghanistan should switch from the export of carpets to the export of aircraft.
d. the US would retain its comparative advantage in carpet manufacture.
e. the US would retain its absolute disadvantage in the manufacture of both goods.
1.35 Which of the following is recorded on the financial (capital) account of the balance of payments?

a. A group of South Africans spends three weeks touring Europe
b. A monetary gift from Canadian citizens to their relatives in South Africa
c. A German firm pays R5-million dividends to the holders of its shares in South Africa
d. An American firm sells its shares in a South African construction firm
e. A group of German tourists visits the Kruger National Park in South Africa for two weeks

1.36 Which of the following summarises transactions involving a country’s international exchange of goods, services, current transfers and income?

a. Current account
b. Financial account
c. Balance of payments
d. Gold standard
e. Balance of trade

1.37 Which of the following would most likely contribute to a deficit (or reduce the surplus) on the South African current account?

a. A depreciation of the rand
b. A Malaysian company invests in a South African oil company
c. An increase in transfers from Italian citizens to their South African relatives
d. A decline in imports
e. An increase in mine workers’ transferring earnings to Mozambique

1.38 The foreign exchange rate is the rate at which

a. one country’s goods trade for those of another country.
b. the currency of one country trades for the goods of another country.
c. currencies of different countries are exchanged.
d. one country’s currency trades for silver provided by another country.
e. the services of one country trade for the currency of another country.

1.39 Suppose that the euro/US dollar exchange rate changes from 1,3 euros per dollar to 1,1 euros per dollar. Then

a. the euro has depreciated against the dollar.
b. this will increase the demand for eurozone goods by the United States.
c. this will lead to a decline in exports by the United States to the eurozone.
d. the euro has appreciated against the dollar.
e. the dollar has appreciated against the euro.
1.40 The exchange rate is $0.50 = R5.00. If a car sells for $16 000, then its cost in rands would be
   a. R80 000.
   b. R16 000.
   c. R12 800.
   d. R160 000.
   e. R64 000.

1.41 The exchange rate between the euro (€) and the US dollar ($) is $1.20 per euro. If an American tourist in Paris purchases a good valued at 60 euros, then in his/her own currency this would cost
   a. $50.
   b. $72.
   c. $48.
   d. $720.
   e. $18.

1.42 A tariff is
   a. a tax on exported goods.
   b. a source of revenue to the exporting nation.
   c. a tax on imported goods.
   d. a tax on foreign property.
   e. a form of quota.

1.43 An import quota is
   a. the real terms of trade.
   b. a penalty for failure to comply with the rules of the World Trade Organisation.
   c. the voluntary restraint on products from foreign countries.
   d. a limit on the quantity of foreign goods that can be sold in a nation’s domestic markets.
   e. a tax on imported goods.

1.44 Tariffs benefit domestic producers by
   a. decreasing the wage rate for labour in the domestic industry.
   b. reducing the prices of imported goods.
   c. increasing sales of domestic goods.
   d. increasing government revenue.
   e. increasing domestic consumers’ real income.
1.45 The removal of tariff protection for the South African textile industry is likely to
a. harm South African consumers.
b. benefit the textile industry.
c. harm the clothing industry that uses textiles as an input.
d. increase government revenue collection.
e. cause some unemployment in this industry.

1.46 Net Domestic Product is equal to Gross Domestic Product net of

a. inflation.
b. indirect taxes.
c. subsidies.
d. net factor payments.
e. depreciation/consumption of fixed capital.

1.47 If dairy farming is subsidised, we would expect the value of a litre of milk to be

a. equal to the price paid by the consumer for a litre of milk.
b. greater than the price paid by the consumer for a litre of milk.
c. less than the price paid by the consumer for a litre of milk.
d. lower because of the subsidy.
e. higher because of the subsidy.

1.48 For a given year, Statistics South Africa found that nominal GDP calculated at
market prices was different from nominal GDP calculated by the income
method. Which of the following items would account for the difference?

a. Depreciation on capital equipment
b. Inflation
c. Interest on loans
d. Indirect taxes and subsidies
e. Net incomes from abroad

1.49 Expenditure on South African goods by foreigners represents

a. an injection into the circular flow of economic activity in South Africa.
b. an injection into the circular flow of economic activity in South Africa,
   unless the revenue generated is used for further consumption purchases.
c. a leakage from the circular flow of economic activity in South Africa.
d. a leakage from the circular flow of economic activity in South Africa, if the
   resultant revenue generated is not saved.
e. a leakage from the circular flow of economic activity in South Africa, if the
   resultant revenue is used for further consumption purchases.
1.50 Aggregate spending on South African production comprises
   a. private consumption, government spending, private investment and total savings.
   b. private consumption, government spending, private investment and net exports.
   c. private consumption, government transfers, private investment and net exports.
   d. private consumption, government investment, private savings and net exports.
   e. private consumption, government spending, private investment and spending by foreigners on South African goods.

QUESTION 2 [10]

Study the following Lorentz curve and then answer the questions:

2.1 What does the Lorentz curve illustrate? (2)
2.2 What does line OB represent? (1)
2.3 Which line is the Lorentz curve? (1)
2.4 What is the shaded area called? (1)
2.5 Where will you find the greatest possible inequality? (1)
2.6 With reference to the Lorentz curve above, how is the Gini coefficient calculated? (2)
2.7 When will the Gini coefficient be zero? (1)
2.8 When will the Gini coefficient be one? (1)

QUESTION 3 [10]

Which of the following are changes in injections and which are changes in withdrawals in South Africa’s circular flow of income? In each case, specify whether the change is an increase or decrease *ceteris paribus*.

3.1 The local council funds a new metro project for the city. (2)
3.2 The government raises tax allowances. (2)
3.3 A leading South African company wins a major overseas contract. (2)
3.4 Government reduces child benefits. (2)
3.5 Depreciation in the exchange rate affects the popularity of holidays abroad. (2)
QUESTION 4 [10]

In a system of market-determined exchange rate, how would the following affect the price of the rand in terms of the dollar? Explain your answer in terms of whether there is a shift in the demand or supply curves (or both) and which way the curve(s) shift.

4.1 More capital goods are imported from China. (2)
4.2 Net investments in South Africa increase. (2)
4.3 Speculators believe the exchange rate will fall. (2)
4.4 Interest rates in South Africa fall relative to those abroad. (2)
4.5 South Africa experiences a high rate of inflation. (2)

QUESTION 5 [10]

The South African Reserve Bank regards financial stability as its most important objective. Identify and discuss two (2) areas where the South African Reserve Bank plays a pivotal role in pursuit of this objective.

PRESENTATION [10]

ASSIGNMENT TOTAL: 100