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Economics, 2016 EC, social science, entrance exam

Grade 12 · Economics · 2016 E.C.

MARKING KEY — CONFIDENTIAL

Time allowed: 120 minutes **Questions:** 30 **Total marks:** 30

1. Which one of the following represents the increase in the quantity supplied of the real GDP due to the increase in the price level? (1)

A. The right wards shifts of the aggregate supply curve

B. The left ward shifts of the aggregate supply curve

C. The down wards movement along the aggregate supply curve.

D. ✓ **The upwards movement along the aggregate supply curve**

Answer: D

A change in the **price level** moves the economy along a fixed aggregate supply curve. Because the short run AS curve slopes upward, a higher price level makes firms willing to sell more real output, so the economy slides up the curve.

A shift of the whole curve (options A and B) comes from something else, such as a change in wages, input prices or technology, and not from the price level itself.

Textbook: Economics Grade 12, Unit 2, section 2.2.2 The Upward Sloping Aggregate Supply Curve: The Short Run (SRAS).

2. When the economy is in the long run which of the following is correct? (1)

A. Sticky wages and workers misperception still holds true

B. ✓ **What the economy produces is the full employment real GDP**

C. The short run and the long run GDP will the same

D. The level of the real GDP the economy produces is less than the natural real GDR

Answer: B

In the long run wages become flexible and workers no longer misjudge prices. When those two short run conditions disappear, the economy settles at the full employment level of output, also called natural real GDP.

Option A states the short run conditions, so it cannot describe the long run, and option D describes a recession rather than long run equilibrium.

Textbook: Economics Grade 12, Unit 2, section 2.2.3 The Vertical Aggregate Supply Curve: The Long Run (LRAS).

3. What is the pressure on price when the quantity demand of the real GDP is greater than the quantity supplied of real GDP during the short run? (1)

A. ✓ **The price levels rises**

B. The price levels drops

C. No pressure at all

D. Initially downwards

Answer: A

If buyers want more real GDP than sellers are offering, there is excess demand. Buyers compete for the limited output, and that competition pushes the general price level up until the two quantities match again.

Prices only fall (option B) in the opposite case, when quantity supplied is greater than quantity demanded.

Textbook: Economics Grade 12, Unit 2, section 2.3 Equilibrium of Aggregate Demand and Aggregate Supply.

4. Which one of the following is correct about the economy when it is in long run equilibrium? (1)

A. ✓ **The economy produces the real GDP which is called the natural real GDP**

B. The short run aggregate demand curve intersect the short run aggregate supply curve

C. The long run aggregate demand curve intersect the short run aggregate supply curve

D. Price temporarily deviates from equilibrium even if aggregate demand and aggregate supply remain unchanged.

> **Answer:** A
>
> Long run equilibrium is the point where wages and prices have finished adjusting and workers have no misperceptions. The output produced there is the natural real GDP, the full employment level.
>
> Option B is tempting because AD does cut SRAS, but that alone only describes short run equilibrium. What makes the position a long run one is that output equals natural real GDP.
>
> **Textbook:** Economics Grade 12, Unit 2, section 2.2.3 The Vertical Aggregate Supply Curve: The Long Run (LRAS).

5. Which one of the following is represent economic situation where there is an inefficient distribution of goods and services in the free markets? (1)

A. Externalities

B. Asymmetric information

C. ✓ **Market failure**

D. Free riding

> **Answer:** C
>
> Market failure is the general name for any situation in which a free market allocates resources badly, so goods and services are distributed inefficiently.
>
> Externalities, asymmetric information and free riding are all *causes* or *examples* of the problem. The question asks for the situation itself, which is market failure.
>
> **Textbook:** Economics Grade 12, Unit 3, section 3.1 Market Failure.

6. What impacts on our aggregate demand do you expect if the level of economic activities in other countries increase? (1)

A. ✓ **Aggregate demand will increase**

B. Aggregate demand will decrease

C. Aggregate demand remain unaffected

D. Aggregate demand first declines and then rises

> **Answer:** A
>
> The level of economic activity abroad is one of the factors that shift the aggregate demand curve, because it decides how much foreigners buy from us.
>
> When other countries grow, they buy more of our exports. Net exports are part of aggregate demand, so AD shifts to the right and increases at every price level.
>
> **Textbook:** Economics Grade 12, Unit 2, section 2.1.3 Shifts in the Aggregate Demand Curve.

7. Among the following which one differentiates changes in quantity demanded from change in aggregate demand? (1)

A. As price level falls, the quantity demanded real GDP rises, ceteris paribus

B. ✓ **It represented as the movement from one points to another along the different demand curve**

C. A positive change in any factors causes a right ward shift in the AD curve

D. It is a shift in Aggregate demand curve from ADI to AD2 on different curve

> **Answer:** B
>
> A change in the **quantity demanded** of real GDP is caused by the price level alone, and it is drawn as a movement from one point to another along the same aggregate demand curve. A change in **aggregate demand** is a shift of the whole curve from AD1 to AD2.
>
> So the feature that separates the two ideas is movement along the curve rather than a shift of it, which is what option B describes. Options C and D both describe a shift, so they belong to the other concept.
>
> Note that the printed option says "different demand curve" where the textbook says "the same demand curve", which looks like a scanning error.
>
> **Textbook:** Economics Grade 12, Unit 2, section 2.1.3 Shifts in the Aggregate Demand Curve.

8. Which one of the following is correct about Aggregate demand curve? (1)

A. It represent the inverse relationship between the real GDP demand and consumption expenditure, all else being equal.

B. It's a schedule that represents the amount of real output that sellers collectively desire to sell at each price, ceteris paribus

C. ✓ **It shows the inverse relationship between the amount of real output buyers desire to buy at each price, all else being equal.**

D. It shows the inverse relationship between the amount of real output sellers desire to sell at each price, all else being equal.

> **Answer:** C
>
> Aggregate demand shows how much real output **buyers** want to buy at each price level, and the link is inverse: a higher price level goes with a smaller quantity of real GDP demanded.
>
> Options B and D describe sellers, so they define aggregate supply instead. Option A wrongly puts consumption expenditure in place of the price level.
>
> **Textbook:** Economics Grade 12, Unit 2, section 2.1.2 The Aggregate Demand Curve.

9. What is the implication of the Keynesian Horizontal aggregate supplycurve? (1)

A. ✓ **Firms can supply whatever amount demand at the existing price because of unemployment.**

B. Firms can obtain much labor as they want as long as they pay more

C. As output level changes, the average cost of production increases

D. The labor market in equilibrium with full employment of the labor force

> **Answer:** A
>
> The Keynesian aggregate supply curve is horizontal because the economy has unemployed workers and idle machines. Firms can therefore produce any extra amount that is demanded without having to raise their price.
>
> Option B fails on the wage point: in this range firms get all the labour they want at the *current* wage, so they do not need to pay more. Option D describes the classical vertical curve, not the Keynesian one.
>
> **Textbook:** Economics Grade 12, Unit 2, section 2.2.1 Concept of Aggregate Supply.

10. Which one of the following is the main factor that affect the amount of output firms are willing to supply? (1)

A. The price related to goods produced by other firms

B. ✓ **The price they receive for their goods**

C. The level of the economic activity in other countries

D. The prices they anticipate to prevail in the future

Answer: B

The amount of output a firm is willing to supply depends first of all on the price it receives for its own product, because that price decides the revenue and the profit on each unit sold.

Prices of other firms' goods, activity abroad and expected future prices do matter, but they are secondary influences that shift the supply curve. The own price is the main factor.

Textbook: Economics Grade 12, Unit 2, section 2.2.2 The Upward Sloping Aggregate Supply Curve: The Short Run (SRAS).

11. Which one of the following is not the cause of market failure? (1)

A. Monopoly

B. Factors immobility

C. Externalities

D. ✓ **Private goods**

Answer: D

The commonly listed causes of market failure are externalities, monopoly, information asymmetry and factor immobility. Public goods are the standard illustration of the problem.

Private goods are the opposite case. They are rivalrous and excludable, so a competitive market can price them and allocate them efficiently on its own.

Textbook: Economics Grade 12, Unit 3, section 3.1.1 Common Types of Market Failures.

12. Suppose Sol-ech - Company receives positive externalities from COMP educated graduate subsidize computer education through scholarship. In which of the following group is this type of solution for market failure listed? (1)

A. Voluntary collective action solution

B. Government imposed solution

C. ✓ **Private market solution**

D. Non-excludability

Answer: C

Solutions to market failure fall into three groups: private market solutions, government imposed solutions and voluntary collective action.

Here the company itself pays for the scholarships. It is a private firm buying the benefit it already receives from trained graduates, so this is a **private market solution**. The textbook uses exactly this example, a technology company funding computer education through scholarships, in the private group.

It is not a government imposed solution, because no tax, subsidy or regulation from the state is involved. Government imposed solutions in the same section are things like taxes on tobacco or state subsidies.

Textbook: Economics Grade 12, Unit 3, section 3.1.2 Solutions to Market Failures.

13. Which one of the following is an example of public goods? (1)

A. Houses

B. ✓ **Wilderness**

C. Food items

D. Clothes

Answer: B

A pure public good is non rivalrous and non excludable. The textbook lists national defence, clean air, biodiversity and **wilderness** as examples.

Houses, food items and clothes are pure private goods: if one person consumes them, another cannot, and non payers are easy to shut out.

Textbook: Economics Grade 12, Unit 3, section 3.2 Public Goods.

14. Which one of the following characterize public goods? (1)

A. Rivalry and excludability

B. Rivalry and non -excludability

C. Non- Rivalry and excludability

D. ✓ **Non-rivalry and non -excludability**

> **Answer:** D
>
> Public goods have two defining features. **Non rivalry** means one person's use does not reduce the amount left for others, so the extra cost of serving one more user is zero. **Non excludability** means it is hard or very costly to stop non payers from using the good.
>
> The other options each keep one private good feature, so they describe private or impure goods instead.
>
> **Textbook:** Economics Grade 12, Unit 3, section 3.2 Public Goods.

15. Which one of the following factor is the reason for market inefficiency in the provision of public goods? (1)

A. Externality

B. Diversity

C. ✓ **Free riding**

D. High marginal cost

> **Answer:** C
>
> Because a public good is non excludable, a person can enjoy it without paying for it. That is free riding.
>
> If everyone waits for someone else to pay, private firms collect too little revenue and the good is under supplied or not supplied at all. That is why the market is inefficient here and why the government usually steps in.
>
> **Textbook:** Economics Grade 12, Unit 3, section 3.2 Public Goods.

16. Which one of the following microeconomic policy involves by which the government manipulates its expenditure and revenue side? (1)

A. Monetary policy

B. Income policy

C. ✓ **Fiscal policy**

D. Exchange rate policy

> **Answer:** C
>
> Fiscal policy is the government's use of its two budget sides: what it spends and what it collects in revenue, mainly taxes.
>
> Monetary policy works through the money supply and interest rates, income policy through wages and price controls, and exchange rate policy through the price of foreign currency. Only fiscal policy is about the budget.
>
> **Textbook:** Economics Grade 12, Unit 4, section 4.2 Fiscal Policy.

17. Which one of the following instrument is considered by the contractionary fiscal policy when there is an excess demand and inflationary pressure in the economy? (1)

A. ✓ **A decrease in expenditure**

B. An increase in expenditure

C. Reduction of taxes

D. reduction of revenue

> **Answer:** A
>
> Excess demand and inflation call for contractionary fiscal policy, which is meant to pull aggregate demand down.
>
> The government does that by **cutting its expenditure** or by raising taxes. Raising spending or cutting taxes would add to demand and make the inflation worse, so options B and C point the wrong way.
>
> **Textbook:** Economics Grade 12, Unit 4, section 4.2.2 Types of Fiscal Policy.

18. A tight monetary policy is applied in circumstance where there is (1)

A. ✓ **High inflation**
B. High economic growth
C. High unemployment
D. Slow economic growth

Answer: A

A tight or contractionary monetary policy shrinks the money supply and raises interest rates. Borrowing becomes dearer, spending and investment fall, and the pressure on prices eases.

That is the right medicine for **high inflation**. Where there is high unemployment or slow growth the central bank does the opposite and loosens policy.

Textbook: Economics Grade 12, Unit 4, section 4.3.2 Types of Monetary Policies.

19. If tight fiscal and monetary policies fail to address the problem of rising price level, what is the alternative policy that the government should consider? (1)

A. Exchange rate policy
B. ✓ **Income policy**
C. Trade policy
D. Interest rate policy

Answer: B

Income policy means economy wide controls on wages and prices, such as wage guidelines, price ceilings and price floors.

The textbook is direct about this: a government can turn to income policy if restrictive fiscal and monetary policies fail to bring the rising price level down. Exchange rate and trade policy work on external flows, not on the domestic wage and price spiral.

Textbook: Economics Grade 12, Unit 4, section 4.4 Income Policy and Wage.

20. Which one of the following exchange rate regime is the one is determined by the government political and economic decisions? (1)

A. Floating exchange rate regime
B. ✓ **Fixed exchange rate regime**
C. Managing floating
D. Crawling peg regime

Answer: B

Under a fixed exchange rate policy the rate is set by the government's political and economic decisions, and the authorities defend that rate. A change in it is called devaluation or revaluation.

Under a floating regime the rate comes from supply and demand in the market, and a change is called depreciation or appreciation. Managed floating and a crawling peg are mixed systems in which the market still has a role.

Textbook: Economics Grade 12, Unit 4, section 4.5 Foreign Exchange Policies.

21. Which one of the following difference is the cause for efficiency loss in the presence of negative externalities? (1)

A. Between marginal social benefits and marginal private benefits
B. ✓ **Between marginal social cost and marginal private cost**
C. Between private marginal cost and marginal external cost
D. Between private marginal benefits and marginal external benefits

Answer: B

A negative externality means the activity imposes a cost on outsiders, for example smoke from a factory. The producer only counts its own cost, the marginal private cost, while society bears the marginal social cost, which is higher.

The gap between marginal social cost and marginal private cost is exactly what the producer ignores, so it produces too much and welfare is lost. Option A is the gap that matters for a *positive* externality, where benefits are the ones spilling over.

Textbook: Economics Grade 12, Unit 3, section 3.3 Externalities.

22. When insurance company provides fringe benefit and marginal benefits on the basis of an average rate over set of employees and guarantee them to participate in the program, then this can see as solution for which one of the following problem? (1)

A. ✓ **Adverse selection**
B. signaling
C. Moral hazard
D. screening

Answer: A

Adverse selection is the hidden information problem: when insurance is voluntary, the people who expect to claim are the ones who buy it, and the healthy stay out, so the pool becomes bad and the price rises.

Charging one average rate to a whole group of employees and making everyone take part removes that self selection, because low risk and high risk people are covered together. That is the standard cure for adverse selection.

Moral hazard is different: it is the change in behaviour *after* a person is insured, and it is treated with deductibles and co payments rather than group enrolment.

Textbook: Economics Grade 12, Unit 3, section 3.4 Asymmetric Information.

23. Which one of the following macroeconomic policies involves management of money supply and interest rate? (1)

A. Fiscal policy
B. Exchange rate policy
C. ✓ **Monetary policy**
D. Income policy

Answer: C

Monetary policy is run by the central bank and works on the money supply and the interest rate.

Fiscal policy is about government spending and taxes, income policy about wages and prices, and exchange rate policy about the value of the currency, so none of them fits the description.

Textbook: Economics Grade 12, Unit 4, section 4.3 Monetary Policy.

24. Which one of the following is the monetary policy tool that involves the purchase and sale of securities by the nation's central bank? (1)

A. Discount rate
B. ✓ **Open market operation**
C. Required reserve ratio
D. Government spending

Answer: B

Open market operation is the central bank buying or selling government securities. Buying puts money into the banking system and expands the money supply, and selling takes money out.

The discount rate is the price the central bank charges banks for loans, and the required reserve ratio is the share of deposits banks must hold. Both are monetary tools too, but neither involves trading securities. Government spending is fiscal, not monetary.

Textbook: Economics Grade 12, Unit 4, section 4.3.1 Tools of Monetary Policy.

25. Which one of the following is considered to be fiscal policy tool? Which one is it? (1)

A. ✓ **Taxation**
B. Grants in aid
C. Investment
D. Transfer payment

Answer: A

The textbook names two tools of fiscal policy: **taxation** and government spending. Taxation changes the income people have left to spend, which changes consumption and real GDP.

Transfer payments and grants in aid are listed as components inside government spending rather than as tools in their own right, and investment is a decision of firms, not a government instrument. So taxation is the tool asked for.

Textbook: Economics Grade 12, Unit 4, section 4.2.1 Tools of Fiscal Policy.

26. Which one of the following is correct about price ceiling? (1)

A. It is one of the income policies that keeps a price from declining from certain limit

B. ✓ **It is a maximizing price set by law to make a basic consumption goods affordable to buyers**

C. It should be set above the equilibrium price to make it more effective

D. It is discourages consumers from buying goods and services since they are now paying higher prices.

> **Answer:** B
> A price ceiling is a legal maximum price. It is put on staples such as food and fuel when they become too dear for ordinary buyers, so the aim is to keep essentials affordable.
>
> A ceiling only bites when it is set *below* the equilibrium price, so option C is wrong, and because it lowers the price paid, buyers want more rather than less, so option D is wrong too. Keeping a price from falling is a price floor.
>
> **Textbook:** Economics Grade 12, Unit 4, section 4.4 Income Policy and Wage.

27. Suppose the value of an Ethiopian Birr in terms of Kenya Shilling is getting higher. What is the impact of this on the Ethiopian export to Kenya? (1)

A. It will make the price of Ethiopian goods in the Kenya market cheaper

B. It will make the price of Kenyan import in the Ethiopian market expensive.

C. It will increase Ethiopia's export earning

D. ✓ **It will reduce Ethiopia's export earning**

> **Answer:** D
> If the birr becomes worth more shillings, the birr has appreciated. A Kenyan buyer now needs more shillings to pay for the same Ethiopian goods, so our goods look expensive in the Kenyan market.
>
> Kenyans therefore buy less from Ethiopia and export earnings fall. Option A says the opposite, and option B is wrong as well: a stronger birr makes Kenyan imports *cheaper* in Ethiopia, not more expensive.
>
> **Textbook:** Economics Grade 12, Unit 4, section 4.5 Foreign Exchange Policies.

28. Which one of the following clearly define taxation? (1)

A. It is a voluntary payment

B. It is the only source of government revenue.

C. ✓ **It is levied without anything in direct return**

D. It encourage inexistence of government

> **Answer:** C
> Tax is a compulsory, unrequited payment to government. Unrequited means the taxpayer gets nothing in direct return, because the benefits a person receives are not tied to the amount that person paid.
>
> Option A is wrong because tax is compulsory, not voluntary, and option B is wrong because government also raises money by borrowing, by charging fees and by printing money.
>
> **Textbook:** Economics Grade 12, Unit 5, section 5.1.1 Definition and Terminologies in Taxation.

29. Which one of the following explains the tax principles called "canon of economy"? (1)

A. Everyone should pay tax according to his ability

B. The amount of tax that we are supposed to pay should be known in advance.

C. Every tax payer should pay the tax in his own convenient

D. ✓ **The cost of tax collection should be as minimum as possible.**

> **Answer:** D
>
> Among Adam Smith's canons of taxation, the **canon of economy** says that every tax has a cost of collection and that this cost should be kept as low as possible, so that most of what is collected reaches the treasury.
>
> The other options name different canons: ability to pay is the canon of equity, knowing the amount in advance is certainty, and paying at a suitable time is convenience.
>
> **Textbook:** Economics Grade 12, Unit 5, section 5.1.3 Principles of Taxation.

30. Which one of the following is the implication one a good tax is referred to as broad bases? (1)

A. The system should impose tax on all people without discrimination

B. The system should ensure that an income inequality is reduced

C. ✓ **The system should impose tax on income and properties and commodities**

D. The system should ascertain that national income and living standard is increasing.

> **Answer:** C
>
> A broad based tax system is one that does not lean on a single source. Tax is levied not only on income but also on property and on commodities, so the burden is spread and revenue is steadier.
>
> Taxing everyone without discrimination, reducing inequality and raising living standards are separate features of a good tax system. They are not what the word "base" refers to.
>
> **Textbook:** Economics Grade 12, Unit 5, section 5.1.4 Characteristics of a Good Tax System.

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