

KABARAK



UNIVERSITY

UNIVERSITY EXAMINATIONS

2009/2010 ACADEMIC YEAR

FOR THE DEGREE OF BACHELOR OF SCIENCE

ECONOMICS AND MATHEMATICS

COURSE CODE: ECON 220

COURSE TITLE: INTERMEDIATE ACROECONOMICS

STREAM: Y2S2

DAY: THURSDAY

TIME: 3.00 – 5.00 PM

DATE: 12/08/2010

INSTRUCTIONS:

1. Attempt question **ONE** and any other **TWO** questions
2. Appropriate diagrams may be used to illustrate an answer.
3. All workings must be shown clearly.

PLEASE TURNOVER

1. a) Considering the theoretical and policy points of view, distinguish between Keynesian macroeconomics and monetarism. **(5mks)**

b) You are given the following information about the economy of county K:

$C = 100 + 0.8Y_d$	(consumption function)
$I = 50$	(Investment)
$G = 50$	(Government spending)
$X = 10$	(Exports)
$M = 5 + 0.1Y$	(Import function)
$T = 50 + 0.25Y$	(Tax function)

Where Y = national income and Y_d = disposable national income.

- Compute the equilibrium level of output and consumption. **(5mks)**
 - Calculate the disposable income and net exports that correspond to the equilibrium level of national income **(3mks)**
 - What is the balance of trade from 1 (b) (ii) above? Classify country K on the basis of economic development and explain why it is experiencing the balance of trade you have identified. **(3mks)**
 - Suppose government spending decreased by 20, what would be the change in income and consumption **(4mks)**
 - Determine and interpret the size of government expenditure multiplier and tax multiplier on output **(4mks)**
 - Which of the two multipliers in 1 (b) (v) above, is bigger? Explain your answer. **(2mks)**
- c) Explain clearly the use of multipliers in economic analysis. **(4mks)**

2. a) Consider a hypothetical economy described by the following equations:

$C = 90 + 0.625Y^d$	(Consumption function)
$I = 150 - 100r$	(investment function)
$G = 20$	(Government spending)
$M^s = 180$	(Real money supply)
$M^d_T = 0.25Y$	(Transaction demand for money function)
$M^d_{sp} = 50 - 200r$	(Speculative demand for money function)

Where:

r = rate of interest

Y = income

- Specify both the IS and LM equations **(6mks)**
 - Solve for equilibrium values of Y and r that simultaneously clear the product and money markets. **(5mks)**
 - Calculate the equilibrium values of C and I . **(4mks)**
- b) Explain the main propositions of the life –cycle hypothesis. **(5mks)**

3. a) i) What is IS curve **(1mk)**
 ii) With reference to only the commodity market, what would be the direction of shift of IS curve if there is a contractionary fiscal policy **(3mks)**
- b) State Say's law and explain its application in monetary economy **(5mks)**
- c) i) What is balanced – budget multiplier? **(1mk)**
 ii) Suppose the government follows a balanced budget policy, how will this affect the national income? **(3mks)**
 iii) Suppose that in (3) (c) (ii) above, the government pursues a deficit-budget policy, what effects will this have on national income? **(3mks)**
- d) What is the contribution of commercial banks to the money supply process **(4mks)**
4. a) Critically evaluate the absolute income hypothesis **(4½mks)**
 b) With reference to Keynesian theory, explain reasons why economic agents desire to hold Money **(6mks)**
- c) i) What is LM curve? **(1mk)**
 ii) With reference to the money market, explain the factors that cause a shift in LM curve. **(4½mks)**
- d) Explain the determinants of money multiplier. **(4mks)**