



**MASENO UNIVERSITY**  
**UNIVERSITY EXAMINATIONS 2013/2014**

**FIRST YEAR SECOND SEMESTER EXAMINATIONS FOR  
THE DEGREE OF MASTER OF SCIENCE IN FINANCE  
(CITY CAMPUS – EVENING)**

**BEC 802: ADVANCED MACROECONOMICS**

Date: 16<sup>th</sup> July, 2014

Time: 5.30 – 8.30 p.m.

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**INSTRUCTIONS:**

- Attempt ANY FOUR questions.
- Each question carries 15 marks.



### QUESTION ONE

"The present and the future are based on the contributions of the past." Discuss the foregoing statement with reference to the origin and growth of macro economics under the following subheadings:

- (i). Classical macroeconomics. (5marks)
- (ii). Keynesian revolution. (5marks)
- (iii). Post Keynesian developments. (5marks)

### QUESTION TWO

Friedman's permanent income model can be stated algebraically as  $C_p = bY_p$ , where:  $C_p$  = permanent consumption,  $b$  = proportion of permanent income and  $Y_p$  = permanent income. If Friedman measures permanent income at time "t" as:  $Y_p = \omega Y_t + \omega(1-\omega)Y_{t-1} + \omega(1-\omega)^2 Y_{t-2} + \dots + \omega(1-\omega)^{t-1} Y_{t-t}$ , if in Friedman's own permanent income estimate,  $\omega = 0.33$ . Assuming further that income of a household in the year 2012 = Ksh 160,000 and that income for the same household in 2011 was 50% of the 2012 income;

- (a). Estimate the households permanent income for the year 2012. (10marks)
- (b). What was the household's permanent consumption and saving in the year 2012 if MPC is 0.8. (5marks)

### QUESTION THREE

- (i). Distinguish between the concept of zero budget and the balanced budget concept. (3marks)
- (ii). (a). Suppose you are the secretary in charge of Finance in your country which faces a problem of inequality in income distribution, explain with the help of an illustration, how you would use fiscal policies to ensure equality in income distribution in the country. (6marks)
- b). Suppose the consumption model of your country is given as  $C = c(Y) = 100 + 0.75Y$ , and that the country faces a deflationary gap of 40 million USD. How much should the government collect through taxation to ensure a balanced budget? Explain your answer. (6marks)

#### QUESTION FOUR

Suppose the following specifications are provided for a hypothetical economy:

*Consumption function*  $C = \alpha_0 + \alpha_1(Y - t_s)$ ; *Investment*  $(I) = I_0 - hr$ ;

*Government expenditure*  $(G) = G_0$ ;  $M^d = (1 - \alpha_1)Y - hr$ ;  $M^s = 200$

Where “ $r$ ” is % interest rate.

- (a) Establish the IS and LM models for the economy. (5marks)
- (b) Determine the equilibrium income and interest rate for the economy. (3marks)
- (c) With the help of a diagram, explain the equilibrium condition in the money market and the capital/goods market. (7marks)

#### QUESTION FIVE

- (a). Explain the basic proposition of monetary approach to the balance of payments adjustments. (7marks)
- (b). Succinctly explain how a disequilibrium in balance of payments correct itself. Illustrate graphically. (8marks)