MUEO

MOI UNIVERSITY

OFFICE OF THE DEPUTY VICE CHANCELLOR ACADEMIC AFFAIRS, RESEARCH AND EXTENSION

UNIVERSITY EXAMINATIONS

2013/2014 ACADEMIC YEAR

SECOND YEAR END OF SEMESTER I/II EXAMINATIONS

FOR THE DEGREE OF
BACHELOR OF BUSINESS MANAGEMENT

EXAM CODE: **BBM 212/ECO 311**

EXAM TITLE: **INTERMEDIATE MACROECONOMICS**

DATE: 9TH SEPTEMBER, 2014 TIME: 9.00 A.M.–12.00 NOON

INSTRUCTION TO CANDIDATES

- SEE INSIDE

THIS PAPER CONSISTS OF (2) PRINTED PAGE

PLEASE TURN OVER

BBM 212/ ECO 311 INTERMEDIATE MACROECONOMICS

ANSWER ANY FOUR QUESTIONS

ALL QUESTIONS CARRY EQUAL MARKS

QUESTION ONE

(a) Consider an economy described by the following equations (in billion £)

$Y = C + I + G + (X - M)$

$C = 220 + 0.85Y_d$

$I = 300$

$G = 600$

$T = 100 + 0.15Y$

$TR = 400$

$X = 500$

$M = 50 + 0.05Y$

Required

(i) Calculate the equilibrium values for all the endogenous variables ***(10 marks)***

(ii) Calculate the budget surplus or deficit and the trade balance ***(4 marks)***

(iii) If the equilibrium income computed in (a) is 800 billion less than full employment income level, by how much must government spending be increased in order to obtain full employment? How will the government budget situation be affected? ***(3 marks)***

(b) Discuss the concept of balanced budget theorem and prove that the balanced budget multiplier is always equal to one ***(8 marks)***

QUESTION TWO

(a) Discuss the Life – cycle theory of consumption and compare this theory with the Friedman's Permanent income hypothesis. State the main contributions of these consumption theories in macroeconomic analysis ***(13 marks)***

(b) Describe the instruments of monetary and fiscal policies. What are the target variables of monetary and fiscal policies? ***(12 marks)***

QUESTION THREE

(a) Explain how financial crowding out can reduce the effectiveness of fiscal policy. What determines the magnitude of crowding out? ***(10 marks)***

(b) Consider an economy with the following specification:

$C = 100 + 0.8Y_d$

$I = 150 - 6r$

$G = 100$

$T = 0.25Y$

$X = 100$

$M = 20 + 0.1Y$

$M_d = 0.2Y - 2r$

$M_s = 300$

Required:

(i) Derive the IS and LM functions ***(6 marks)***

(ii) Compute the equilibrium level of income (Y) and the rate of interest (r) ***(4 marks)***

(iii) Suppose money supply increases to 400, what would be the level of equilibrium income and interest rate? ***(5 marks)***

QUESTION FOUR

(a) Given the Phillip's curve relations, what kind of policy dilemma is faced by the policy makers? How will you react to the option of making a choice between a high rate of unemployment and a high rate of inflation? Give reasons for your choice ***(15 marks)***

(b) Discuss the various ways in which policy can raise the level of investment. What kinds and combinations of policies would be needed to raise the share of investment when the economy is at the full – employment income level? ***(10 marks)***

QUESTION FIVE

Explain clearly the following economic concepts

(i) Internal Rate of Return
(ii) Discretionary and Compensatory Fiscal Policies
(iii) Money Multiplier
(iv) The Accelerator Principle
(v) Business Cycles

(5 marks each)

QUESTION SIX

Compare and contrast the Classical and Keynesian theories on the determination of output, prices and employment.

Are these theories applicable or relevant in developing countries like Kenya? ***(25 marks)***