

**KABARAK**



**UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**2009/2010 ACADEMIC YEAR**

**FOR THE DEGREE OF BACHELOR OF  
ECONOMICS AND MATHEMATICS**

**COURSE CODE: ECON 220**

**COURSE TITLE: INTERMEDIATE  
MACROECONOMICS**

**STREAM: Y2S2**

**DAY: FRIDAY**

**TIME: 9:00 – 11:00 A.M.**

**DATE: 19/03/2010**

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**INSTRUCTIONS:**

1. This papers contains five (5) questions
2. Apart from question ONE all other question carries equal marks. Marks for subdivisions are shown in brackets.
3. Marks will be awarded to candidate who demonstrates clarity and accuracy of presentation.
4. Diagrams should be used where helpful.

**PLEASE TURNOVER**

## QUESTION 1

- a) Consider an economy described by the following equations.

$C = 15 + 0.75Y^d$	[Consumption function]
$I = 32$	[Investment function]
$G = 50$	[Government expenditure]
$T = 4 + 0.2Y$	[Tax function]
$X = 17$	[Export function]
$M = 2 + 0.1Y$	[Import function]
$R = 10$	[Transfer payments]

Where:

$Y$  = National Income

$Y^d$  = Income after tax

### REQUIRED

- a) (i) Calculate Equilibrium level of National income. ( 5 marks)  
(ii) Calculate levels of consumption, Balance of Trade, and Government's budget that correspond to the equilibrium level of National Income. (3 marks)  
(iii) Derive the savings function for this economy. (3 marks)
- b) If the equilibrium level of National income (a) above falls short of full employment level of income by 50, how much should the government change her expenditure or taxes to achieve full employment level? (6 marks)
- c) (i) What is balanced Budget? (2 marks)  
(ii) Explain why it's possible to change equilibrium income keeping balance budget.  
  
That is keeping  $\Delta G = \Delta T$ . (4 marks)
- d) Which fiscal policy between changes in Government expenditure and tax would you recommend to achieve macroeconomic objectives? (4 marks)
- e) Distinguish between autonomous consumption and induced consumption. ( 3 marks)

## QUESTION 2

- (a) Distinguish between actual and potential GDP. (4 marks)
- (b) (i) What is Business cycle? (2 marks)  
(ii) Explain why Business cycle is of concern to macroeconomic policy maker?  
(4 marks)
- (c) What is stagflation? Explain why Keynesian economics was unable to solve the stagflation problem of the early 1970's. (6 marks)

- (d) Explain the effect of tax reduction on the equilibrium level of National income and price level according to Supply side economics.(4 marks)

### QUESTION 3

- a) Define Say's law and explain its application in Barter economy. ( 5 marks)
- b) Distinguish between Classical Price adjustment mechanism and Keynesian Income adjustment mechanism. (6 marks)
- c) Explain the three ranges of Aggregate supply curve clearly bringing out the policy implication in each range. ( 9 marks)

### QUESTION 4

- (a) Explain the classification theory of demand for money. (5 marks)
- (b) What is the difference between income velocity in Classical theory of demand for money and Liquidity preference theory of demand for money? (7 marks)
- (c) What are quasi or near monies and why are they considered as part of money supply? (3 marks)
- (d) Give initiative justification of the effects of changes in income on the equilibrium money stock and interest rate. (5 marks)

### QUESTION 5

- (a) Define and graphically derive the I-S curve. ( 10 marks)
- (b) Explain why the I-S curve is downwards sloping. (5 marks)
- (c) Show that for all other points, other than the points on the I-S curve, either  $S > I$  or  $I > S$ . (5 marks)