



*(Knowledge for Development)*

**KIBABII UNIVERSITY  
UNIVERSITY EXAMINATIONS**

**2021/2022 ACADEMIC YEAR**

**THIRD YEAR SECOND SEMESTER**

**SPECIAL/SUPPLEMENTARY EXAM**

**FOR THE DEGREE OF BACHELOR OF  
COMMERCE/COOPERATIVE AND  
ENTREPRENEURSHIP/BUSINESS MANAGEMENT/EDUCATION**

**COURSE CODE: ECO 221/ECO311/ECO205**

**COURSE TITLE: INTERMEDIATE MACRO-ECONOMICS**

**DATE: 29<sup>TH</sup> JULY 2022**

**TIME: 2.00 - 4.00PM**

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**INSTRUCTIONS TO CANDIDATES**

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B
2. Question one carries 30marks and each of the other two questions carry 20 marks each.

TIME: 2 Hours

KIBU observes ZERO tolerance to examination cheating

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### QUESTION ONE

- i) Briefly discuss the evolution of macroeconomics [6 marks]
- ii) Differentiate between the following paired concepts
- a) Real flow variable and stock variable [4 marks]
- b) Life cycle hypothesis and permanent income hypothesis [4 marks]
- iii) Illustrate with the help of a diagram how expansionary monetary and fiscal policies causes a shift in the LM curve [9 marks]
- iv) The data below for the year 2016, use total expenditure approach to calculate National Income. [4 marks]

Item	US Dollars(Billions)
Government Expenditure on goods and services	250
Compensation of employees	1,675
Gross private domestic investment	325
Rental income	20
Personal consumption expenditures	1425
Net export of goods and services	100
Indirect business taxes and depreciation	300

- ii) Outline the limitations of the above method (2 marks)

### QUESTION TWO

Assume the following model of the closed economy in the short run, with the price level (P) fixed at 10:

$$C = 0.5(Y - T)$$

$$T = 1,000$$

$$I = 1,500 - 250r$$

$$G = 1,500$$

$$M_s = 1,000$$

$$m_d/p = 0.5Y - 500r$$

- (a) Write a numerical formula for the IS curve, showing Y as a function of r alone [5 marks]
- (b) Write a numerical formula for the LM curve, showing Y as a function of r alone [5 marks]

(c) What are the short-run equilibrium values of  $Y$ ,  $r$ , and national saving ( $S$ )? [5 marks]

(d) Assume that  $G$  increases by 1,500 (i.e.,  $G = 3,000$ ). By how much will  $Y$  increase in short-run equilibrium? [5 marks]

### QUESTION THREE

In the Keynesian cross model, assume that the consumption function is given by  $C = 200 + 0.75(Y - T)$  and planned investment = 100, government purchases and taxes are each of them 100

i) Draw a graph of planned expenditure as a function of income [5 marks]

ii) What is equilibrium level of income? [5 marks]

iii) If government purchases increase to 125 what is the new equilibrium income [5 marks]

iv) What level of government purchases is needed to achieve the income of 1600? [5 marks]

### QUESTION FOUR

Consider the following behavioral equations:

$$C = C_0 + c_1 Y_D.$$

$$T = t_0 + t_1 Y.$$

$$Y_D = Y - T.$$

$G$  and  $I$  are both constant.

Assume that  $t_1$  is between zero and one.

- Solve for equilibrium output. [5 marks]
- What is the multiplier? Does the economy respond more to changes in autonomous spending when  $t_1$  is zero or when  $t_1$  is positive? Explain. [5 marks]
- Why fiscal policy in this case called an automatic stabilizer? [3 marks]
- Write short notes on:
  - Permanent-income Hypothesis [4 marks]
  - Life-cycle Hypothesis [3 marks]

### QUESTION FIVE

- a) Explain the three Keynes motives of holding money. (6marks)
- b) Discuss the causes and solutions to BOP dis-equilibrium in your country. (8 Marks)
- c) Distinguish between classical view and Keynesian view of aggregate supply.(6 Marks)