MACHAKOS UNIVERSITY

University Examinations for 2018/2019 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FOURTH YEAR SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS

EET 101: MACROECONOMIC THEORY 1

DATE **TIME**

INSTRUCTIONS

Answer question one and any other two questions. Question one carries 30 marks and the other questions carry 20 marks each.

<u>Question One (Compulsory)</u>

(a) The structural model of an Economy is given as below

$C = 500 + 0.7Y^d$ *Consumption function*

$I = 270$ *Investment*

$G = 450$ *Government expenditure*

$T = 200$ *Tax*

<u>Required</u>

(i) Derive the savings function **(2 marks)**

(ii) Derive and compute the government expenditure multiplier explain your answer **(3 marks)**

(iii) Compute the equilibrium income (Y) and consumption (C) **(4 marks)**

(b) Using a phase diagram show the derivation of Equilibrium in the goods market **(5 marks)**

(c) Currently Kenya's economy has been experiencing persistent rises in the prices of various commodities. In the context of Kenya, explain what you think are the causes of these persistent increases in the general price levels of commodities.

(8 marks)

(d) Explain the meaning of a balance of trade deficit and discuss any four approaches that can be used to correct it. **(8 Marks)**

Question Two

a) Using a well labeled flow diagram, discuss the injections and withdrawals in the circular flow of an economy's Income **(10 marks)**

b) For a country to experience economic growth and development, it must ensure that there are adequate levels of investments in the country alongside other items. However, the levels of investments are influenced by a number of factors. Using Kenya as an example, explain the factors that determine the level of investments in a country **(10 marks)**

Question Three

a) Describe the Keynesian theory of money demand highlighting the factors that determine Money demand in the economy **(12 marks)**

b) Unemployment is a key policy issue in Kenya. Most qualified people in Kenya remain jobless despite their tireless efforts to secure themselves a job. Most of the youth engage in crimes and illegal activities due to this menace. Why do you think that many people in Kenya still remain unemployed despite several efforts by the government to solve the problem **(8 Marks)**

Question Four

a) With the aid of a well labeled diagram, describe the life cycle income hypothesis of consumption behavior. Is this theory applicable in Kenya? Explain. **(10 marks)**

b) Is per capita income a good measure of measuring social welfare? Explain your answer **(6 marks)**

c) Explain any two types of unemployment **(4 Marks)**

Question Five

(a) The following set of equations describe the economy of country P

$Y = C + I + G + X - M$	*Equilibrium equation*
$C = 2000 + 0.8Y^d$	*Consumption function*
$I = 3500$	*Investment*
$G = 3700$	*Government expenditure*
$X = 2500$	*Exports*
$M = 400 + 0.3Y$	*Import equation*
$T = 100 + 0.25Y$	*Tax equation*

Required

(i) Compute the equilibrium National income for country P **(4 Marks)**

(ii) Obtain the trade balance and describe the position **(3 Marks)**

(iii) Compute the tax multiplier and government expenditure multiplier. Interpret your results. **(4 Marks)**

(iv) Based on your results for (iii) above, what policy, between increasing government expenditure and tax cut, will be effective in increasing the country's National income? Give reasons **(3 Marks)**

(b) Briefly explain any three goals of macroeconomic policy **(6 marks)**