MACHAKOS UNIVERSITY

University Examinations for 2021/2022 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

FIRST YEAR FIRST SEMESTER EXAMINATION FOR

MASTER OF ECONOMICS

EET 801: ADVANCED MACROECONOMICS THEORY I

DATE: 15/12/2021 **TIME: 9.00-12.00 PM**

INSTRUCTIONS:

1. Answer Question **ONE** and any other **THREE** questions

2. **Do not** write on the question paper.

QUESTION ONE (COMPULSORY) (24 MARKS)

a) Derive the Solow condition using the basic efficiency model. Show and illustrate using the effort curve that the wage paid when the Solow condition is fulfilled is the efficient wage. (5 marks)

b) Keynesian aggregate supply curve is horizontal. Critically examine the validity of this statement. (4 marks)

c) Using relevant diagrams explain the effect of expansionary fiscal policy under flexible exchange rate with imperfect capital mobility. (6 marks)

d) Using Cobb Douglas production function derive factors that determine rental price of capital. (3 marks)

e) The equilibrium in goods market is characterized with the following equations;

$y = c(y - t(y)) + i + g$ (Product Market)

$\frac{m}{p} = l(r) + k(y)$ (Money Market)

Required:

i. Derive and interpret the slope of the IS Curve (3 marks)

ii. Derive and interpret the slope of the LM Curve (3 marks)

QUESTION TWO (12 MARKS)

a) Compare and contrast the arguments of monetarist macroeconomics and new classical macroeconomics. Name three influential economists from each school of thought. (8 marks)

b) Distinguish between elasticity and absorption approach to Bop. (4 marks)

QUESTION THREE (12 MARKS)

a) Consider the following equations of an hypothetical economy

c=50+0.8yd

i=10-8r

g=100

T=0.25y)

(M/P)d=y-25r

M=1475

P=10

Required;

Compute and interpret the values of both the monetary and fiscal policy multipliers (8 marks)

b) The Classical theory of aggregate demand centres around the quantity theory of money. Discuss. (4 marks)

QUESTION FOUR (12 MARKS)

a) Explain the purchasing power parity. Clearly criticize this theory. (6 marks)

b) Suppose an economy is experiencing high interest rates that crowd out planned investment. Explain how a policy mix would correct this situation. (6 marks)

QUESTION FIVE (12 MARKS)

a) Set up summers' efficiency wage model, and indicate how it differs from the basic efficiency model. (4 marks)

b) Clearly distinguish between absolute income hypothesis and permanent income hypothesis. (6 marks)

c) Although Tobin Q theory appears different, it is strongly related to the user cost model. Explain. (2 marks)