

**CHUKA**



**UNIVERSITY**

**UNIVERSITY EXAMINATIONS**

**CHUKA AND EMBU CAMPUSES**

**EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR OF ECONOMICS**

**ECON 222: INTERMEDIATE MACROECONOMICS**

**STREAMS:**

**TIME: 2 HOURS**

**DAY/DATE: FRIDAY 06/12/2019**

**2.30 P.M. – 4.30 P.M.**

**INSTRUCTIONS:**

- Answer question ONE and any other TWO.

**QUESTION ONE**

(a) The following equation describes a certain economy.

$$C = 400 + 0.75Y^d$$

$$I = 200 - 100r$$

$$T = 70 + 0.2Y$$

$$G = 100$$

$$X = 10$$

$$M = 150 + 0.6Y$$

$$MS = 4000$$

$$MDS = 1200 - 18r$$

$$MDY = \frac{1}{8}Y$$

- (i) Derive the IS and LM equations. (6 marks)
- (ii) Find the equilibrium income and interest rates in the two markets. (4 marks)
- (iii) Calculate  $C^e$ ,  $T^e$ ,  $I^e$  and  $N^e$  (8 marks)
- (b) The natural rate of unemployment cannot be eliminated permanently by means of expansion of any policy. Use diagram to explain this statement. (8 marks)

- (c) Savings is the difference between disposable income and consumption. Using a well labelled diagram, present the savings equation. (4 marks)

**QUESTION TWO**

- (a) With aid of a well-labelled diagram, discuss the monetary disturbance in the classical model with decrease in income velocity. (8 marks)
- (b) Discuss in detail the concept of paradox of thrift with aid of a diagram. (6 marks)
- (c) Proof that  $MPS + MPC = 1$ . (6 marks)

**QUESTION THREE**

- (a) Given that

$$C = \alpha + PY$$

$$I = I_0$$

$$Y = C + I$$

Derive the multiplier, hence, suppose that autonomous investment  $I_0$  increases by  $\Delta I$ . Derive the investment multiplier.

- (b) A good tax system should distribute the tax burden as equitably as possible. Discuss two types of such equity. (4 marks)
- (c) Discuss the following theories of consumption.
- (i) Permanent income hypothesis
- (ii) Ratchet effect (5 marks)

**QUESTION FOUR**

- (a) Briefly discuss the criticisms of classical pillars of macroeconomics. (10 marks)
- (b) Critically examine the accelerator theory of investment. (6 marks)
- (c) Discuss the role of public sector in an economy. (4 marks)
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