SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE
PROGRAMME

YEAR II SEMESTER II
END SEMESTER EXAMINATION – APRIL 2015

BEC 20225 Macroeconomics

Date	:	24th April 2015
Time	:	9.00 a.m. - 11.30 a.m.
Duration	:	Two and half (02 ½) hours

Instructions to Candidates:

- Paper consists of three Sections (A, B, and C)

- **Answer 06 Questions** including **Question No. 1** from the Section A, any **four (04)** questions from Section B and **one (01)** question from the Section C

- The total marks for the paper is 100.

- The marks for each question are shown in brackets.

- Answers should be written neatly and legibly.

Section A

Multiple Choice Question (Compulsory)

The first question is a multiple choice question consisting of 10 parts, and select the most correct answer given under the each part and mark the number of the correct answer in the separate sheet provided**.**

Question No. 1

1. Out of the following Macroeconomics deals with:
   a. Variables at disaggregated levels.
   b. Partial equilibrium analysis based on *ceteris paribus* assumption.
   c. Allocation of given economic resources.
   d. General equilibrium analysis of aggregate variables

2. Which one out of the following is not considered as a flow variable?
   a. Gross National product (GNP)
   b. Capital stock (K)
   c. Consumption expenditure (G)
   d. Government revenue (R)

3. Which of the following items is not included in the circular flow of income in a three sector model?
   a. Wages, salaries and transfer payments
   b. Tariffs
   c. Factor payments
   d. Consumer expenditure on goods and services.

4. Which of the following statements is incorrect?

    a. Even a voluntary or a frictional unemployment cannot occur under the full employment assumption made by classical macro economists.

    b. Supply creates its own demand.

    c. If there is a perfect competition in both product and labour markets, economy is always in equilibrium or reaching equilibrium.

    d. Money, other than functioning as a medium of exchange, does not play any significant role in determining the output and employment.

5. Suppose that for a hypothetical economy consumption function is given as $C = 100 + 0.75Y$, identify its marginal propensity to save as:

    a. 0.75

    b. 0.25

    c. 100.75

    d. 100.0

6. If the multiplier for a two-sector economy is computed as 4 and a consumer gets an additional amount of Rs. 1000 of income how much he will spend for consumption?

    a. Rs. 250

    b. Rs. 4000

    c. Rs. 1000

    d. Rs. 750

7. If a country wants to acquire an economic growth at a rate of 7% per year while its national savings ratio is 15% and capital output ratio is 3, the country's savings gap based on the Harrod-Domar model is:

    a. 21%

    b. 6%

    c. 5%

    d. 2 .14%

8. Out of the following which reason does not cause cost-push inflation?

   a. Supply-shocks

   b. Profit-pushes

   c. Wage-pushes

   d. Monetary expansions

9. Out of the following which cannot be considered as a quantitative measure of monetary control?

   a. Open market operations

   b. Bank rate

   c. Cash reserve ratio

   d. Direct control

10. Out of the following Gini coefficients, which one represents the least inequality of income distribution?

    a. Gini coefficient lies between 0.50 and 0.70

    b. Gini coefficient lies between 0.20 and 0.35

    c. Gini coefficient lies between 0.05 and 0.10

    d. Gini coefficient lies between 0.75 and 0.90

(02 Marks x 10)

(Total 20 Marks)

Section B

Question No. 2

'GDP measures its output in terms of either income or expenditure. These tow quantities are really the same for the economy as a whole'.

a. Illustrate how national income and national expenditure become the same.

(02 Marks)

b. Suppose that you are considering a two sector model and its consumption function and constant investment are given as below:

$$C = 100 + 0.75Y \quad \text{and} \quad I = 200$$

i. Calculate the equilibrium national income of this two sector economy.

(02 Marks)

Then, assume that it becomes a three sector economy with the introduction of the government activities. Accordingly government increases its expenditure (G) by Rs. 100.

ii. Calculate the equilibrium national income of the three sector economy.

(02 Marks)

Next, think that the government imposes Rs. 100 tax.

iii. Calculate the new equilibrium national income.

(02 Marks)

iv. Based on the above calculations discuss the effect of following budgetary policies of:
   a. Balance budget,
   b. Deficit budget and
   c. Surplus budget on national income determination.

(03 Marks)

v. Explain the effect of deficit and surplus trade balances on aggregate demand and national income determination.

(04 Marks)

(Total 15 Marks)

Question No. 3

Suppose you have been given the following income consumption schedule for an assumed economy (figures are in Rupees billion)

Income (Y)	Consumption (C)
0	50
100	125
200	200
300	275
400	350

a. Calculate average propensity to consume (APC) and Marginal propensity to consume (MPC) schedules,

(06 Marks)

b. and identify that:
   i. There is a non-proportional relationship between average consumption and income; and

(02 Marks)

   ii. There is a proportional relationship between marginal propensity to consumption and income.

(02 Marks)

   iii. Discuss to what extent these short term relationships highlighted by Keynes have been confirmed or challenged by the subsequent empirical studies.

(02 Marks)

c. Select any later developed theory on consumption and discuss how that theory resolves this issue of short term and long term conflicts between average consumption and income in the Keynesian theory of consumption.

(03 Marks)

(Total 15 Marks)

Question No. 4

a. Suppose the following table gives you the money aggregates (in billion rupees) abstracted from the Central Bank's Annual Reports for 2013.

No.	Item	End 2013
1	Currency outstanding	339.8
2	1.1 Currency held by the public	264.6
3	1.2 Currency with commercial banks	75.2
4	Commercial banks' deposits with the CBSL	148.8
5	Demand deposits held by the public with commercial banks	220.0
6	Time and savings deposits held by the public with commercial banks	2574.2
7	Foreign currency deposits	359.1
8	GDP at current market prices	8674

Source: CBSL 2013

Find the following for the year 2013:
  i. Reserve money
  ii. Narrow money supply (M_1)
  iii. Broad money supply (M_2)
  iv. Consolidated broad money supply (M_{2b})
  v. Money multiplier
  vi. Velocity of money

(06 Marks)

b. Suppose an investment function for an assumed economy has been estimated based on the following functional relationship:

$$I = f (O, T, i, Inf)$$

Where I = investment, O = output, T = tax, i = rate of interest and Inf = inflation, and estimated investment function is given as follows:

$$I = 6.5 \text{ O} - 3.0 \text{ T} - 4i + 1.5 \text{ Inf}$$

Interpret the results of the above estimated function using a suitable sensitivity analysis and the relevant theoretical underpinnings.

(09 Marks)

(Total 15 Marks)

Question No. 5

a. Relate with the relevant graphs the equilibrium behavior of the money market (LM) and the commodity or the product market (IS).

(03 Marks)

b. Discuss the relationship and the interdependence of these two markets taking the scenario of the recent slashing of loan interest rates in the Sri Lankan financial market.

(04 Marks)

c. Suppose that related to a product market and a money market you are given the following information:

$$C = 48 + 0.8Y, I = 98 - 75\,i\,, \text{Ms} = 250, \text{Mt} = 0.3y, \text{and Msp} = 52 - 150\,i$$

Where C= consumption, Y = income, I = investment, i = rate of interest, Mt = demand for money from transaction motive and Msp = demand for money from speculative motive. Further, suppose that based on the above information the following augmented matrix has been developed.

$$\begin{bmatrix} .2 & 75 & | & 146 \\ & & | & \\ .3 & -150 & | & 198 \end{bmatrix}$$

Calculate:

i. Equilibrium rate of interest and the level of income when both markets are reaching the state of general equilibrium.

(04 Marks)

ii. Level of consumption, level of investment, demand for money with the transaction motive and the demand for money with the speculative demand at the general equilibrium level of income.

(04 Marks)

(Total 15 Marks)

Question No. 6

a. Explain how the following kinds of inflations can occur:
   i. Demand pull or excess demand inflation
   ii. Cost-push inflation

(04 Marks)

b. Evaluate to what extent monetary policy and fiscal policy can be used to control each of these two inflations.

(04 Marks)

c. Discuss policy makers' dilemma between inflation and unemployment based on modified Philips curve analysis giving some examples from the Sri Lankan economy as well.

(07 Marks)

(Total 15 Marks)

Section C

Question No. 7

'The great depression proved that the very basic assumptions of the classical macroeconomics were wrong'. Elaborate this statement outlining the main assumptions of classical macroeconomics and discussing the contributions made by Keynes against the classical analysis.

(Total 20 Marks)

Question No. 8

'Post-Keynesian developments in macroeconomics have indeed been many and varied; but most of the development was essentially, either refinements or extensions of the basic Keynesian theory'. Discuss this statement tracing the subsequent developments of the subject, Macroeconomics.

(Total 20 Marks)