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

INTAKE II/III/IV – GROUP B
END SEMESTER EXAMINATION – JULY 2016

BEC 20225 Macroeconomics

Date : 22nd July 2016
Time : 5.30 p.m. – 8.00 p.m.
Duration : Two and a half (02 ½) hours

Instructions to Candidates:

- Paper consists of three sections (A,B and C)
- **Answer 06 questions** including **Question No. 1** from Section A, and **four (04)** questions from Section B and **one (01)** question from Section C.
- The total marks for the paper is 100.
- The marks for each question are show in brackets.
- Answers should be written neatly and legibly.

Section A

Multiple Choice Questions (Compulsory)

The first section consists of 10 multiple choice questions. Select the most correct answer given under each question and mark the number of the correct answer given in the separate sheet.

Question No. 01

1. GDP measures;
 - a. the value of all final goods and services produced by citizens of that country during a specific period
 - b. the value of all final and intermediary goods and services produced by residents of that country
 - c. the value of all final goods and services produced within a country during a specific period
 - d. the value of all final goods produced by residents of that country during a specific period
2. According to the Keynesian cross model for a simple economy;
 - a. income is determined by equating investments to savings
 - b. income is determined by equating consumption to savings
 - c. income is determined by equating investments to consumption
 - d. income is determined by equating investments to government expenditure
3. The consumption function for a hypothetical economy is given as $C = 240 + 0.64 Y_d$, its Marginal Propensity to Save (MPS) and Marginal Propensity to Consume (MPC) are;
 - a. 0.36 and 0.64 respectively
 - b. 0.64 and 0.36 respectively
 - c. 1 and 0.64 respectively
 - d. 0.36 and 1 respectively

4. In the IS- LM model, the LM curve will shift only when;
 - a. autonomous expenditure changes
 - b. money demand changes
 - c. money demand changes while money supply increases
 - d. money supply changes

5. During the Sinhala and Tamil New Year, the demand for money increases significantly. If the Central Bank does not take any action to offset the increase in money demand, the nominal interest rates will;
 - a. remain constant
 - b. increase
 - c. decrease
 - d. increase and decrease thereafter

6. An increase in taxes or a cut in transfers tends to ;
 - a. lower the governments planned capital expenditure
 - b. lower the government's budget deficit
 - c. increase the government's budget deficit
 - d. lower the governments planned revenue

7. One of the key roles of the expansionary fiscal policy is to;
 - a. encourage exports
 - b. discourage imports
 - c. achieve equal distribution of income
 - d. accelerate economic growth

8. If the number of units of domestic currency, per unit of foreign currency increases, it can be said that the domestic currency;
 - a. is overvalued
 - b. is undervalued
 - c. has appreciated
 - d. has depreciated

9. The aggregate demand curve shows;
- a. combinations of nominal interest rate and the level of output at which the goods and money markets are in equilibrium
 - b. combinations of the price level and the level of output at which the goods and money markets are simultaneously in equilibrium
 - c. combinations of nominal interest rate and the level of output at which the money market is in equilibrium
 - d. combinations of the price level and the level of national income at which the goods market is in equilibrium
10. The government taking actions to enhance the productivity of human resources in the country is mainly a;
- a. supply side policy
 - b. monetary policy
 - c. demand side policy
 - d. exchange rate policy

(Total 20 Marks)

Section B

Answer **any four (04)** questions

Question No. 02

- i. “Macroeconomics is a social science which deals with the economy as a whole. It also studies the well-being of the citizens of a nation.” Discuss this statement while highlighting the importance of macroeconomic variables.
- (05 marks)
- ii. “A business cycle is a swing in total national output, income and employment of a nation over a period of time”.
- a. Graphically present the four (04) stages of the business cycle.
 - b. Explain how the economic growth and unemployment would change over those four stages.

(05 marks)

- iii. State four (04) main macro-economic objectives of the government and explain two (02) of them.

(05 marks)

(Total 15 Marks)

Question No. 03

- i. Explain the circular flow model for a three sector economy, using an appropriate diagram.

(05 marks)

- ii. Using the Keynesian Cross Model, illustrate and explain the effect of increase in Government Expenditure on the real national income.

(05 marks)

- iii. The information given below are relevant for a hypothetical economy.

Description	Rupees Millions
Household Consumption	1660
Personal Savings	240
Government Transfers	30
Government Expenditure	750
Inventory stock at hand	250
Business fixed Investments	550
Net Indirect Taxes	120
Residential fixed Investments	650
Net Exports	-1000
Imports	1200
Net Factor Income from Abroad	-350

- a. Calculate Gross Domestic Product using the Expenditure Approach.

(03 marks)

- b. Calculate Gross National Product at factor cost prices and current prices.

(02 marks)

(Total 15 Marks)

Question No. 04

- i. Explain the relationship between the Marginal Propensity to Save (MPS) and Marginal Propensity to Consume (MPC).

(05 marks)

- ii. Consider the following information pertaining to a hypothetical economy.

Autonomous Consumption	Rs.280 million
Marginal Propensity to Consumption	0.72
Investment	Rs.120 million
Government Expenditure	Rs.60 million
Lump Sum Tax	Rs.30 million
Income tax rate	20%
Transfers	Rs.10 million

- a. Derive the functions for Disposable Income (Y_d) and Consumption (C) for this economy.

(03 marks)

- b. Calculate Marginal Propensity to Save (MPS) and the expenditure multiplier.

(04 marks)

- c. If government expenditure changes by Rs.30 million by how much would income change?

(03 marks)

(Total 15 Marks)

Question No. 05

- i. The following table displays data for a hypothetical economy. All values are given in Rupees millions.

Variable	Amount
Government Expenditure	200
Autonomous Consumption	648
Autonomous investment	210
Lump sum tax	150
Real money supply	400
Price Level	20

Other information

Marginal Propensity to Consume (MPC)	0.6
Sensitivity of Investment to Interest rate	48
Sensitivity of money demand to Interest rate	376
Sensitivity of money demand to Income	0.2

- a. Derive the equation for Aggregate Expenditure.
(03 marks)
- b. Determine the IS and LM equations.
(04 marks)
- c. Calculate the equilibrium national income and interest rate.
(02 marks)
- ii. If the government increases Government expenditure by Rs.10 million, calculate the new equilibrium income, interest rate and find out the crowding out effect.
(06 marks)
- (Total 15 Marks)**

Question No. 06

- i. Using the IS-LM model, explain the impact on equilibrium output and the interest rate under the following policy scenarios.
- a. Government increases the salaries of the public servants
 - b. Central Bank decides to increase the money supply in the economy
 - c. Government increases lump sum taxes to finance its budget deficit

(12 marks)

- ii. What are the factors which determine the effectiveness of fiscal and monetary policy?

(03 marks)

(Total 15 Marks)

Section C

Answer **only one (01)** question

Question No. 07

A country experiences a persistent budget deficit and economists in the country pointed out that the reason for the budget deficit was increase in government expenditure. However, the revenue generated from direct and indirect taxes are not sufficient to finance the budget deficit. Hence the policy makers have decided to introduce different tax policies to raise revenue. Accordingly, they have proposed to increase the taxes on goods and services, while there is a concern on increase in the taxes on luxury goods.

- a. Discuss the economic implications of the above fiscal policies on different sectors in the economy.

(10 marks)

- b. Using an appropriate model explain the impacts of increase in taxes on the real output of the economy. Discuss the effects of this change on the other macroeconomic variables in the economy.

(10 marks)

(Total 20 Marks)

Question No. 08

A particular economy is growing very fast and the government feels that there will be many repercussions of fast economic growth, which cannot be handled by the economy. The government plans to use the monetary policy as a tool to control the economy.

- a. Explain Monetary Policy tools that can be used by the Central Bank to stabilize the economy. Use an appropriate diagram to illustrate your answer.

(10 marks)

- b. If the government decides not to use the monetary policy what other policies can be used to control this situation? Justify your answer.

(10 marks)

(Total 20 Marks)