UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF ARTS

Second Year General/ BED Degree Examination in Arts (Economics) - 2016/2017

Second Semester Final Examination

ECN 2226 – Intermediate Macroeconomics

(Time Allowed: Two Hours)

Answer any **four (04)** Questions

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(1). (a). Macroeconomic objectives in developing countries are divided into two categories as primary and secondary objectives . What are the rationale behind this. Explain.

(12 marks)

(b). "The fiscal policy in developing countries is apparently conducive in attaining main macroeconomic objectives compared to the monetary policy". Critically explain this statement.

(13 marks)

(2). (a). The General form of the consumption function is given as $C(Y) = a_0 + b_0Y$ where, C is consumption expenditure and Y is national income.

(i) In this equation, the value of 'a_0' is based of exogenous factors. Explain.

(04 marks)

(ii) The level of Consumption (C) does not increase at the same rate as the income (Y) does. It is due to psychological behavior of the people. Explain.

(04 marks)

(iii) Explain the economic meaning of MPC +MPS = 1.

(05 marks)

(b). Calculate the levels of aggregate output of the following table with the formula $Y = (a+I) * 1/(1-mpc)$.

Autonomous Spending	Marginal Propensity to Consume	Investment	Aggregate Output
200	0.5	500	
300	0.5	300	
400	0.4	500	
500	0.5	500	
500	0.6	600	

(06 marks)

(c). Derive the consumption and savings functions using following table.

National Income (Rs. Million)	Consumption Expenditure (Rs. Million)
300	240
500	400

(06 marks)

1

(3).   Suppose following values represent a closed hypothetical economy. (C, I, G, TR are measured in Rs. billions)

    C=300   MPC = 0.7   t = 0.2
    G = 400   I= 200   TR=50

(a). Derive the consumption function of this economy.

(02 marks)

(b). What is the equilibrium level of income?

(06 marks)

(c). What is the value of investment multiplier?

(03 marks)

(d). What is the level of consumption and savings under equilibrium national income?

(03 marks)

(e). Suppose that the government has decided to spend Rs. 1000 million on low income earners as a direct transfer payment (TR). Calculate the new equilibrium level of income.

(06 marks)

(f). Draw a diagram to show all these changes.

(05 marks)

(4).   The following equations describe an open hypothetical Economy. (C, I, G, T, TR and NX are measured in Rs. millions)

    C=200 + 0.8Y   G = 600   T = 10+0.1Y
    I = 350   TR = 160   NX = 25

(a). Estimate the equilibrium level of national income.

(06 marks)

(b). Suppose that the government spending has increased by Rs. 50 million. Estimate new equilibrium level of income.

(04 marks)

(c). As a policy decision, the government has decided to increase the income tax rate by a 10%. What would be the new level of national income?

(06 marks)

(d). What is the value of multiplier under new tax rate?

(03 marks)

(e). Considering all these changes in new expenditure and tax, calculate the level of government's budget deficit/surplus.

(02 marks)

(f). The government has decided to curtail the level of annual welfare expenditures. What would be the effect of this policy on national income? Briefly explain using a diagram?

(04 marks)

(5). Following equations describe a hypothetical economy. (C, I, G, T etc., are measured in Rs. Millions).

$$C = 200 + 0.7Y$$
$$T = 100$$
$$t = 0.1$$
$$I = 700 - 50i$$
$$G = 500$$
$$L = 0.4Y - 20i$$
$$M/P = 900$$

(a). Derive the equations that describe the IS and LM curves.

(08 marks)

(b). What are the equilibrium interest rate and income level?

(05 marks)

(c). Suppose that the government decides to increase the tax rate (t) to 0.2 and money supply by 100 million. What would be the new equilibrium interest rate and income level?

(07 marks)

(d). Explain how does the 'MPC' and 't' affect the IS curve.

(05 marks)

(6). (a). Under the flexible exchange rate system with perfect capital mobility what would be the impact of a fiscal expansion on the interest rate and income? Explain using a diagram.

(15 marks)

(b). When the capital is perfectly mobile and the exchange rate is flexible, show the impact of following policy decisions on national income using diagrams.
   (i) A reduction of welfare expenditures
   (ii) A decrease of reserve ratio

(10 marks)

(7). (a). "Inflation is always and everywhere a monetary phenomenon" Do you Agree? Explain your answer.

(08 marks)

(b). Distinguish the classical view of inflation and the Keynesian view of inflation.

(09 marks)

(c). Examine the trends of inflation in Sri Lanka during past decade giving reasons for such trends.

(08 marks)

(8). Write shot notes on any **two (02)** of followings.
   (a). Keynesian and Classical views on economic growth
   (b). Crowding-out Effect and fiscal policy
   (c). Demand for money and Liquidity Trap
   (d). Neoclassical Economic policies and Sri Lankan Economy

(12.5 marks for each)

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