UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF ARTS

Second Year General/ BED Degree Examination in Arts – 2018/2019
(First Semester Final Examination)

ECN 2126 – Intermediate Macroeconomics

Time Allowed: Two (02) Hours

Answer any **four (04)** Questions

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(1). (a). What are the main macroeconomic objectives in an economy? Examine in brief the problems encountered in achieving all these objectives together.

(12 marks)

(b). "Fiscal policy is more effective than monetary policy in macroeconomic management of developing countries" Examine this statement considering the theoretical and practical limitations of these policies.

(13 marks)

(2). (a). The consumption function of an economy is given as $C = C_0 + bY_d$.

(i) What are the basic characteristics of the consumption function?

(05 marks)

(ii) What do you mean by disposable income? Why is the consumption expenditure based on disposable income? Explain briefly.

(02 marks)

(iii) Briefly explain the relationship between consumption and savings functions.

(03 marks)

(b). The income and consumption expenditure schedule of an individual is given as below.

Income (Rs.)	Consumption Expenditure (Rs.)
48000	40000
60000	48000

(i). Derive the consumption function of this individual.

(04 marks)

(ii). Derive the savings function of this individual.

(04 marks)

(iv). If investment expenditure and government expenditure in the economy is 10000 and 60000 respectively, estimate the level for national income of this economy.

(07 marks)

(3). The following equations describe a hypothetical closed economy (C, I, G, TR are measured in Rs. millions).

$C = 200 + 0.7\,(Y-T)$	$T = 60$
$TR = 50$	$t = 0.2$
$G = 400$	$I = 250$

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

(02 marks)

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

(06 marks)

(c). What is the level of consumption and savings at equilibrium level of national income?

(03 marks)

(d). what is the value of investment multiplier?

(03 marks)

(e). Suppose that the government has decided to spend Rs. 300 million on building of a network of Mono-rail tracks. Calculate the new level of equilibrium income?

(06 marks)

(f). Draw a rough sketch of graph to show (b) and (e).

(05 marks)

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

$C=100 + 0.7Y$	
$G = 300$	$T = 0.15Y$
$I = 250$	$TR = 75$
$X = 50$	$M = 25$

(a). What is the equilibrium level of national income?

(06 marks)

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

(04 marks)

(c). As a policy decision, the government decided to raise its income tax rate by 5%. Calculate the new equilibrium level of national income.

(06 marks)

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

(03 marks)

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

(02 marks)

(f). The government has decided to impose a new tariff on importation of vehicles. What would be the effect of this policy on imports and national income? Explain Briefly.

(04 marks)

(5). Following equations describe an economy (C, I, G, T etc., are measured in Rs. Trillions).

$$C = 120 + 0.5\,(Y - T)$$
$$I = 50 - 40r$$
$$T = 80$$
$$G = 200$$
$$Ms = 90$$
$$L = 0.6Y - 30r$$

(a). Derive the IS and LM equations.

(08 marks)

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

(05 marks)

(c). Suppose that the government decides to introduce a new income tax (t) of 10% and to increase money supply by 50 Trillion. What would be the new equilibrium interest rate and income levels?

(07 marks)

(d). Explain verbally the impact of an increased income tax rate on the IS curve.

(05 marks)

(6). (a). Under the flexible exchange rate system with perfect capital mobility, what would be the effect of an increase of government expenditure on the national income? Explain using a diagram.

(15 marks)

(b). When the capital is perfectly mobile and the exchange rate is fixed, show the impact of following policy decisions on the national income using diagrams.

(i) An investment promotion

(ii) A reduction of reserve ratio

(10 marks)

(7). Write shot notes on any **two (02)** of following.

(a). Liquidity Trap and Crowding out Effect

(b). Great Economic Depression in 1930s and Keynesian Policy Approach

(c). Recessionary and Inflationary gaps in an economy

(d). Neo liberal policies and Economic stabilization of developing countries

(12.5 marks for each)

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