ALUPE UNIVERSITY COLLEGE

...*Bastion of Knowledge*....

OFFICE OF THE DEPUTY PRINCIPAL

ACADEMICS, RESEARCH AND STUDENTS' AFFAIRS

UNIVERSITY EXAMINATIONS

2018 /2019 ACADEMIC YEAR

FIRST YEAR SECOND SEMESTER REGULAR EXAMINATION

FOR THE DEGREE OF BACHELOR OF ARTS IN ECONOMICS

COURSE CODE:ECO 120
COURSE TITLE:PRINCIPLES OF MICRO ECONOMICS

DATE: 23/04/2019   TIME: 9.00AM-12.00PM

INSTRUCTION TO CANDIDATES

- **SEE INSIDE**

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INSTRUCTIONS TO CANDIDATES

- *Answer Question **ONE** and any other **TWO** questions*
- *Question ONE carries 30 marks*
- *Time allowed: 3 hours*

Question One

a) The government wants to reduce the fiscal deficit, but it is worried about the negativeconsequences such a policy might have on the level of output. What combination of monetaryand fiscal policies would you recommend to decrease the deficit? Use suitable diagrams toillustrate. (5 marks)

b) How could the government offset the inflationary pressure of a fiscal expansionWhile an expansionary fiscal policy shifts the IS to the right, increases Y and the inflationaryPressure (5marks)

c) Highlight the likely effect of the introduction of ATMs on Gross Domestic Product (5 marks)

d) The government is planning to leverage a 5% tax on every ATM and debit card transaction. Thegovernment projects that this will increase output since it shall be an incentive for people tospend rather than to keep their money in the bank. Advise the government on the probableimplication(s) of such a policy. (5 marks)

e) Given:

$$Y = C + I0 + G0 \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (1)$$

$$C = a + b(Y-T) \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (2)$$

$$T = d + tY \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (3)$$

Compute the equilibrium values of Y^*, C^* and I^* (5 marks)

f) Differentiate between fiscal and monetary policies and show how the two policies are used to influence the economy.

Question Two

a) Consider an economy described by the following equations:

S= -200+ 0.2Yd, Planned Investment I= 100, Government Purchases G= 200, Taxes T= 150

i) Derive the consumption function

ii) Compute the tax multiplier and autonomous spending.

iii) What level of Government spending is needed to achieve and income of 2000?

(10 marks)

b) Answer TRUE or FALSE and justify your answer.

i) Monetary policy is the policy of the government with respect to government spending, taxation and transfers.

ii) An increase in the production of Brooke Bond Tea in Kenya will raise the GDP of Kenya while having no effect in the GDP of the United Kingdom.

iii) A high marginal prospensity to consume (MPC) increases the effect of any expansion in autonomous investment.

iv) The estimated rent of a house owner residing in his own house is included in the GDP of Kenya.

v) National savings equals Y-C-G and in an open economy, at equilibrium, must equal 1.

(10 marks)

Question Three

(a) What is inflation? Discuss the different types of inflation and the method the government uses to control it.   Ort   (5 Marks)

(b) By use of a diagram, explain the difference between the types of inflation mentioned.

(5 Marks)

(c) How do governments use interest rates as a monetary policy instrument? Give examples.

(5 Marks)

(d) By use of a diagram show why the negative relationship between investment and rate of interest is called Investment Demand Function. (5 Marks)

Question Four

(a) Kenya is a member of the World Bank and IMF. Outline and discuss benefits the country gets from IMF and the World Bank. (8 Marks)

(b) Research suggests that there are four determinants of growth of total output. Explain each of them. (6 Marks)

(c) How do shifts in aggregate demand and aggregate supply affect economic growth? When is a market equilibrium achieved? (6 Marks)

Question Five

(a) The Goods and money markets for an economy are given by the following;

Goods Market

$C = 89 + 0.6Y$

$I = 120 - 150r$

Money Market

$Mt = 0.1Y - 250r + 240$

$Ms = 275$

Where C is consumption, Y is income, r is the rate of interest, Mt is the transactional, precautionary

and speculative demand for money and Ms the money supply. Compute the equilibrium income and

interest rate (4 marks)

b) Compute Y^*, C^* and Investment for the following model:

$Y = C + I + Go$

$C = 100 + 0.8Y$

$Io = 80 + 0.1Y$

$Go = 200$

Where C is consumption, Y is income, I is investment, Go is autonomous government spending,

(4marks)

c) Consider the following consumption and tax functions

$C = 120 + 0.7Yd$

$T = to + t1Y$

$Y = 400$

Where C is consumption, Y is income, Yd is disposable income given by [Y-T], T is taxes, to is lump

sum tax, t1Y is proportional tax

Compute;

i. The level of consumption expenditure if no taxes are levied (4 marks)

ii. The level of consumption if a lump sum tax of 20 is levied on income (4 marks)

iii. The level of consumption if in addition to the lump sum tax of 20 in (ii); a proportional tax of 0.1(10%) is levied on income (4 marks)