KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2014/2015

DIGITAL SCHOOL OF VIRTUAL AND OPEN LEARNING

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF PUBLIC POLICY ANALYSIS

APP 805: MACROECONOMIC THEORY FOR PUBLIC POLICY

DATE: SATURDAY, 2ND MAY 2015 **TIME: 9.00 A.M. – 12.00 P.M.**

INSTRUCTIONS:

Answer **QUESTION ONE** and any other **TWO QUESTIONS**

QUESTION ONE

a) The behaviour of producers is fundamental in the establishment of equilibrium income in macroeconomics. With the aid of well labeled diagrams, explain how equilibrium income is achieved. (8 marks)

b) The following data was presented to a macroeconomist trained at Kenyatta University.

GDP	4,527,000
Personal Consumption Expenditures	3,012,000
Gross Private Domestic Investments	713,000
Net Exports of Goods and Services	-123,000
Government Purchase of Goods and Services	925,000

Comment on the proportion of expenditure components to the size of the economy. Why would consumption always take the largest component of an economy? Is this realist in the Kenyan case? Explain. (5 marks)

c) Kenyatta University's Public Policy Department students' are provided with the following convex Philips curve:

$$\dot{W} = -\alpha + \beta.\frac{1}{u}.$$

The coefficient β was estimated to be 11.74. Given that KIPPRA has estimated the productivity growth to be 2.3, calculate Kenya's Non accelerating Inflation Rate of Unemployment (NAIRU)u_n. (7 marks)

d) Understanding expectations especially on the price level is crucial to any macroeconomic analysis. Compare and contrast as clearly as possible the difference between adaptive and rational expectations. Which of the two suites Kenyan data? (4 marks)

e) The following equations describe a certain economy

$c = 200 + 0.68y^d; i = 100 - 5r; g = 800; l = 0.2y - 100r; m = 6000,, p = 15,$

$X = 200, M_i$ =10-0.25y

Where: c is real consumption expenditure

i is real gross investment

g is real government expenditure

I is real money demand

M is nominal money supply

The tax rate is 30 percent

Mi is imports

X are exports

Required:

Compute both the fiscal and monetary policy multipliers and interpret your results. Show using the multipliers when both multipliers would be most effective. (6 marks)

QUESTION TWO

a) Explain your understanding of the business cycle. (9 marks)

b) With economic growth (growth in GDP), several macroeconomic variables are expected to change. Using well labeled diagrams, show the possible effects of increasing income on interest rates. (6 marks)

QUESTION THREE

a) Equilibrium income is an important concept in macroeconomics. Demonstrate the meaning of equilibrium income and show how it is determined. (8 marks)

b) The new government has promised to reduce unemployment in Kenya. As a public policy graduate, suggest five ways in which the government may reduce youth unemployment in Kenya.

QUESTION FOUR

a) With the use of well labeled diagrams, differentiate between fiscal and monetary policy. (6 marks)

b) Outline the sources of both the cost push and demand pull inflation. How would fiscal and monetary policy be used to solve inflation problems in an economy? (9 marks)

QUESTION FIVE

Write a short essay on how the government can reduce unemployment and ensure that it is sustainable. (15 marks)