

**THE OPEN UNIVERSITY OF SRI LANKA**  
**BACHELOR OF MANAGEMENT STUDIES DEGREE (BMS) LEVEL 04**  
**FINAL EXAMINATION 2006/2007**  
**MACRO ECONOMICS - MCU 2207**



**DURATION : THREE (03) HOURS**

**DATE : 10.02.2007**

**TIME : 1.30 p.m – 4.30 p.m.**

Answer only **five (05)** questions.

1.
  - i. Briefly explain the major macro economic goals of a country. (6 Marks)
  - ii. Explain with examples. why it is important for a manager to study macro economics. (14 Marks)
  
2.
  - i. What is circular flow of income in two sector economy with savings? (5 Marks)
  - ii. Details of a three sector economy are given below.  
 Investments  $\bar{I} = 80$  billion,  
 Government expenditure  $\bar{G} = 100$  billion.  
 Savings  $S = -60 + 0.2Y$ 
    - a. What is the consumption function? (2 Marks)
    - b. Calculate the national income? (3 Marks)
    - c. Suppose the government introduced a lump sum tax of 10 billion. Find the new national income. (4 Marks)
    - d. Assume that the following changes took place in the economy. The country engaged in international trade and exports ( $\bar{X}$ ) worth 60 billion. The value of imports was,  $M = 30 + 0.2Y$   
 In addition to the lump sum tax, the government introduced an income tax of  $0.1Y$ .  
 Calculate the new national income. (6 Marks)

3. i. Briefly explain the three motives of holding money? (5 Marks)
- ii. "In Liquidity Trap expansionary fiscal policy is highly effective and monetary policy is completely ineffective". Do you agree? Explain with illustrations. (9 Marks)
- iii. Explain the outcome of the following given conditions using IS-LM framework.
- The Central Bank reduces the reserve requirement of commercial banks.
  - The government proposes to increase its expenditure.
  - The domestic price level increases. (2x3=6Marks)
4. i. What is the difference between Demand Pull and Cost Push inflation? (8 Marks)
- ii. Explain the negative impact of inflation on a country's economy. (12 Marks)
5. i. What is induced unemployment? (4 Marks)
- ii. What kind of steps should the government take to reduce Structural and Frictional unemployment? (6 Marks)
- iii. "Although official unemployment rate is a good indicator to measure the performance of the economy, it has limitations". Do you agree? Explain. (10 Marks)
6. i. Explain how the government can use fiscal policy to eliminate recessionary gap? (6 Marks)
- ii. How does the multiplier concept relate to these fiscal policy? What are the advantages and disadvantages of such policies? (14 Marks)
7. i. Explain how the Classical, Keynesians and Monetarists differ in their view on Income Velocity? (6 Marks)
- ii. How does the Keynesian approach differ from the Classical approach on the money supply and price level? (14 Marks)
8. Write brief notes on;
- Savings function
  - Money as a dynamic force in the economy
  - Nominal and Real Gross Domestic product.
  - Narrow and Broad Money Supply. (5x4 = 20 Marks)