

BACHELOR OF ARTS EXAMINATION, 2018

(2nd Year, 3rd Semester)

ECONOMICS (HONOURS)**MACROECONOMICS - I**

Time : Two hours

Full Marks : 30

Answer **Q1** and any **two** from the rest.

All questions carry equal marks.

2. a) In a simple Keynesian economy, let $MPC = 0.5$, autonomous expenditure = 250 (all types combined) and tax rate = 0.2. Suppose the government increases expenditure by 600. This is done in the current period only. Find out what percentage of multiplier value is realised after third period. 4
- b) To prove stability in the small in the IS-LM model, show the importance of the assumption of linearity in the functional relations embodied in the markets. Using this property, algebraically prove the stability condition. 2+4=6
3. In an open economy macro model, suppose the money market equilibrium locus shows an income elasticity of rate of interest of 0.7 while that in the BOP equilibrium locus shows a similar elasticity of 0.8. In this case, do you think both monetary and fiscal policy will be equally successful if the exchange rate is fixed ? 10
4. Suppose in a modified Complete Keynesian model, workers may have two alternative price expectations formula –
 i) $P_e = \frac{1}{2}P$ and ii) $P_e = \sqrt{P}$. What difference does it make for the two alternative formulations ? Explain in terms of AD and AS diagrams. Also, analyse whether unemployment equilibrium is possible in both the cases. 6+4=10

1. a) In order to cut budget deficit in the economy, the government (i) reduces Transfer Payments (by cutting old age pensions) from 3% to 2% of GDP (ii) raises taxes (by increasing sales taxes) from 9% to 10% of GDP (iii) reduces government expenditure (by cutting all incentive schemes) from 22% to 20% of GDP. As a result, due to the cut in export incentives, the net exports declines from 6% to 5% of GDP. Other things remaining unchanged, find out the following :
- (A) Change in the private savings ratio to GDP,
 (B) Change in the budget deficit to GDP ratio,
 (C) Change in the NFA ratio to GDP.
 (D) Change in the investment ratio to GDP.
- b) If overtime, both Laspeyers and Paasche price indices show inflation in the economy, then prove that Laspeyers index is more than Paasche index if the aggregate utility function in a 2-good economy is $U = x_1^\alpha x_2^\beta$ ($\alpha + \beta = 1$), where x_1 & x_2 are quantities of the two goods. 6

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