



ATD LEVEL III

PRINCIPLES OF ECONOMICS

MONDAY: 21 May 2018.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

QUESTION ONE

- (a) Summarise four uses of a production possibility curve. (4 marks)
 - (b) Differentiate between “stable market equilibrium” and “unstable market equilibrium”. (4 marks)
 - (c) Outline four conditions that must be fulfilled for consumer rationality to exist. (4 marks)
 - (d) Discuss four applications of the concept of elasticity of demand in an economy. (8 marks)
- (Total: 20 marks)**

QUESTION TWO

- (a) Highlight four functions of money. (4 marks)
- (b) Explain three reasons why the elasticity of supply of agricultural goods is ever low. (6 marks)
- (c) A rational firm in a competitive market has the demand structure and total cost function represented by:

Demand, $P = 50$

Total cost, $TC = 10 + 5Q^2$

Where: P = Price
TC = Total cost
Q = Quantity

Required:

- (i) Average fixed cost function. (2 marks)
 - (ii) Average variable cost function. (2 marks)
 - (iii) Marginal cost function. (2 marks)
 - (iv) The profit maximising level of output. (2 marks)
 - (v) Maximum profit. (2 marks)
- (Total: 20 marks)**

QUESTION THREE

- (a) (i) Define the term “capital” as a factor of production. (2 marks)
 - (ii) Summarise four roles of capital in economic development. (4 marks)
 - (b) Highlight four factors that might lead to increasing return to scale in the production process. (4 marks)
 - (c) Differentiate between “marginal cost” and “marginal revenue”. (4 marks)
 - (d) Describe three circumstances under which the concept of opportunity cost is applicable in an economy. (6 marks)
- (Total: 20 marks)**

QUESTION FOUR

- (a) (i) Define the term “fiscal policy”. (2 marks)
- (ii) List four instruments of fiscal policy. (4 marks)
- (b) Outline six objectives of fiscal policies in an economy. (6 marks)
- (c) The following data relate to a hypothetical economy of country Zed:

	Sh. “million”
Imports	3,000
Exports	5,000
Autonomous consumption	30,000
Government spending	24,000
Investment	6,000

Required:

The equilibrium national income of country Zed, given that the country’s marginal propensity to save is 0.4. (8 marks)
(Total: 20 marks)

QUESTION FIVE

- (a) Summarise five benefits of economic growth and development to an economy. (5 marks)
 - (b) Enumerate five factors that could limit credit creation by commercial banks. (5 marks)
 - (c) Explain the effects of high interest rates on:
 - (i) Investments. (2 marks)
 - (ii) Inflation. (2 marks)
 - (iii) Employment. (2 marks)
 - (iv) Exchange rate. (2 marks)
 - (v) National income. (2 marks)
- (Total: 20 marks)**

QUESTION SIX

- (a) With the help of a well labelled diagram, using indifference curve analysis, derive the demand curve for a normal good. (8 marks)
 - (b) Outline six salient features of a firm operating under oligopoly market. (6 marks)
 - (c) (i) Explain the term per capita income. (2 marks)
 - (ii) Highlight four uses of per capita income. (4 marks)
- (Total: 20 marks)**

QUESTION SEVEN

- (a) Explain the term “money illusion”. (2 marks)
- (b) With the help of a diagram, explain inelastic supply. (4 marks)
- (c) (i) Define the term “economic planning”. (2 marks)
- (ii) Suggest six policy measures that could be implemented to combat poverty in developing countries. (6 marks)
- (d) The market demand and supply functions of commodity X are given below:

$$Q_d = 50 - 2P$$

$$Q_s = - 40 + 3P$$

Where: Q_d is the quantity demanded
 Q_s is the quantity supplied
 P is the price

Required:

The equilibrium price and quantity of commodity X. (6 marks)
(Total: 20 marks)

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