



ATD LEVEL III

PRINCIPLES OF ECONOMICS

MONDAY: 27 November 2017.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

QUESTION ONE

- (a) Highlight four factors that promote the existence of monopolies in an economy. (4 marks)
- (b) Enumerate four contributions of non banking financial institutions in an economy. (4 marks)
- (c) Outline six problems associated with the following approaches of measuring national income:
 - (i) The value added approach. (6 marks)
 - (ii) The expenditure approach. (6 marks)

(Total: 20 marks)

QUESTION TWO

- (a) Distinguish between "arc elasticity" and "point elasticity" of demand. (4 marks)
- (b) Summarise four objectives of trade unions. (4 marks)
- (c) Using indifference curve analysis, illustrate the case for the following types of goods:
 - (i) Perfect substitutes. (6 marks)
 - (ii) Complementary goods. (6 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Highlight five limitations of indifference curve analysis. (5 marks)
- (b) Argue five cases against specialisation of trade. (10 marks)
- (c) The data below relate to the demand and supply of a certain commodity:

| Unit Price (Sh.) | Quantity demanded (Units) | Quantity supplied (Units) |
|---------------------|------------------------------|------------------------------|
| 5 | 160,000 | 40,000 |
| 10 | 150,000 | 52,000 |
| 15 | 138,000 | 60,000 |
| 20 | 105,000 | 80,000 |
| 25 | 96,000 | 125,000 |
| 30 | 65,000 | 138,000 |
| 35 | 50,000 | 180,000 |

Required:

The equilibrium price and quantity of the commodity using the graphical method.

(5 marks)
(Total: 20 marks)

QUESTION FOUR

- (a) Explain two reasons why the marginal cost curve always intersects the average cost curve at the lowest point. (4 marks)
- (b) Outline six limitations of a monopoly market structure in an economy. (6 marks)
- (c) Discuss five barriers to occupational mobility of labour as a factor of production. (10 marks)
- (Total: 20 marks)**

QUESTION FIVE

- (a) The following information relates to the national income statistics of a hypothetical economy in billions of shillings:

| | |
|--|-----|
| Gross national product (at market price) | 777 |
| Depreciation allowance | 143 |
| Subsidies | 26 |
| Indirect taxes | 133 |

Required:

- (i) Net national product at market price. (2 marks)
- (ii) Net national product at factor cost. (2 marks)
- (b) Examine three motives for holding money as advanced by Keynes. (6 marks)
- (c) Discuss ten causes that could lead to high cost of living in a developing country. (10 marks)
- (Total: 20 marks)**

QUESTION SIX

- (a) Using an appropriate diagram, analyse the relationship between the marginal product curve and the average product curve. (5 marks)
- (b) With the aid of a well labelled diagram, explain how monetary policy could be used to control inflationary gap in an economy. (5 marks)
- (c) Describe five instruments of monetary policy that could be used to control the level of money supply in an economy. (10 marks)
- (Total: 20 marks)**

QUESTION SEVEN

- (a) Outline seven challenges encountered by developing countries when implementing development plans. (7 marks)
- (b) The following information relates to the commodity and money markets of a certain closed economy in billions of shillings:

$$\begin{aligned} Y &= C + I \\ C &= 100 + 0.5Y \\ I &= 500 - 10r \\ M_{DT} &= 0.25Y \\ M_{DS} &= 300 - 20r \\ M_S &= 400 \end{aligned}$$

Where: Y is the national income
C is the consumption function
I is the investments function
r is the rate of interest
 M_{DT} is the precautionary and transactionary demand for money
 M_{DS} is the speculative demand for money
 M_S is the money supply

Required:

- (i) The IS function. (4 marks)
- (ii) The LM function. (4 marks)
- (iii) The equilibrium level of interest rate. (3 marks)
- (iv) The equilibrium level of national income. (2 marks)
- (Total: 20 marks)**