



CPA PART I SECTION 2

CS PART I SECTION 2

CIFA PART I SECTION 2

CCP PART I SECTION 2

ECONOMICS

TUESDAY: 24 November 2020.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

QUESTION ONE

- (a) Explain four methods used by the government to stabilise agricultural prices. (4 marks)
- (b) Using suitable examples, differentiate between the following terms as used in economics:
- (i) "Basic human wants" and "secondary human wants". (4 marks)
- (ii) "Public good" and "merit good". (4 marks)
- (iii) "Stable equilibrium" and unstable equilibrium". (4 marks)
- (c) With the aid of a well labelled diagram, illustrate the effect of a simultaneous increase in the income of the consumer and increase in fuel prices. (4 marks)

(Total: 20 marks)

QUESTION TWO

- (a) With the help of a diagram, discuss the concept of an individual engel curve as applied in the theory of consumer behaviour. (5 marks)
- (b) Citing four examples, explain the significance of mobility of factors of production. (8 marks)
- (c) A firm uses two factors of production, labour and capital in the long-run. The price per unit of labour is Sh.1,200 while the price per unit of capital is Sh.900. The firm has a budget of Sh.72,000 which it uses entirely on labour and capital to produce an output level of 500,000 tons.

Required:

- (i) With the help of a diagram, derive the optimal point of the firm. (4 marks)
- (ii) Determine the firm's marginal rate of technical substitution (MRTS). (3 marks)

(Total: 20 marks)

QUESTION THREE

- (a) Examine three sources of monopoly power. (6 marks)
- (b) With the aid of a well labelled diagram, explain the equilibrium level of a firm operating under monopolistic market structure in the long run. (6 marks)

- (c) Assume that a producer has the possibility of discriminating between the domestic and foreign markets for a product with the demand functions given as follows:

$$Q_1 = 16 - 0.2 P_1 \text{ (Domestic market)}$$

$$Q_2 = 90 - 0.5 P_2 \text{ (Foreign market)}$$

Total Cost (TC) of production is given as:

$$TC = 50 + 20Q$$

Required:

Determine the level of output and price to be charged for:

- (i) Domestic market. (4 marks)

- (ii) Foreign market. (4 marks)

(Total: 20 marks)

QUESTION FOUR

- (a) A small hypothetical economy has the following information:

$$C = b_0 + b_1 Y$$

$$I = I_0$$

$$G = G_0$$

$$T = \alpha_0 + \alpha_1 Y$$

Where:

$$C = \text{Consumers expenditure}$$

$$I = \text{Private investment}$$

$$G = \text{Government spending}$$

$$T = \text{Taxes}$$

Required:

- (i) Determine the marginal propensity to save. (2 marks)
- (ii) Derive the equilibrium level of income and taxes. (6 marks)
- (b) Differentiate between "seasonal unemployment" and "frictional unemployment". (4 marks)
- (c) Explain the term "economic planning". (2 marks)
- (d) Highlight six characteristics of a good economic plan. (6 marks)

(Total: 20 marks)

QUESTION FIVE

- (a) Enumerate four factors that determine the velocity of money in circulation. (4 marks)
- (b) (i) Explain the relationship between the multiplier and the accelerator. (4 marks)
- (ii) Evaluate four benefits that might accrue to an economy as a result of accelerator effect. (8 marks)
- (c) Summarise four factors that might lead to an inward shift in the optimal point of a firm. (4 marks)

(Total: 20 marks)

QUESTION SIX

- (a) Justify five reasons for differential interest rates in an economy. (5 marks)
 - (b) With the aid of a diagram, describe the concept of liquidity trap. (4 marks)
 - (c) Using suitable examples, provide three reasons for interest rate decontrol in an economy. (6 marks)
 - (d) Summarise five reasons that make it possible for commercial banks to create credit. (5 marks)
- (Total: 20 marks)**

QUESTION SEVEN

- (a) Summarise six corrective measures that developing countries should institute to correct the persistent deficits in their balance of payments position. (6 marks)
 - (b) Discuss four policy recommendations that developing countries should institute to reduce regional imbalances in their economies. (8 marks)
 - (c) Justify six reasons why external debt problems is a major policy issue in developing countries. (6 marks)
- (Total: 20 marks)**

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