

LAIKIPIA



UNIVERSITY

UNIVERSITY EXAMINATIONS

FIRST SEMESTER 2025/2026 ACADEMIC YEAR

THIRD YEAR EXAMINATION FOR THE DEGREE
OF BACHELOR OF EDUCATION ARTS

BUST -313: ECONOMIC THEORY II

STREAM: *BED (ARTS)*

TIME: *2 HRS*

DAY: *MONDAY [14.30 P.M-16.30 P.M]* ***DATE:*** *2/02/2026*

THIS QUESTION PAPER CONSISTS OF FOUR (4) PAGES

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INSTRUCTIONS: Answer QUESTION ONE and other TWO QUESTIONS**QUESTION ONE (30 MARKS)**

- a) Differentiate between terms of trade and balance of trade **(4 marks)**
- b) Explain how National Income of a country can be measured using expenditure approach **(3 marks)**
- c) Why do people hold money when they can earn interest by lending it to others or by buying interest yielding bonds? **(6 marks)**
- d) The goods market model of a hypothetical economy is given by;

$$Y = C + I+G+X-M$$

$$C = 1320+ 0.5Y^d$$

$$I = 200 -600r$$

$$G = 112$$

$$T = 20 + 0.2Y$$

$$r= 10\%$$

Required;

- i) Interpret the consumption function **(1 marks)**
- ii) Derive and interpret the saving function **(3 marks)**
- iii) Compute the equilibrium national income and consumption **(3 marks)**
- iv) Obtain the trade balance and describe its position **(3 marks)**
- v) Compute the government expenditure multiplier and interpret it **(3 marks)**
- e) Briefly explain the two types of exchange rate regimes. **(4 marks)**

QUESTION TWO (20 MARKS)

- a) Discuss any five types of unemployment that may exist in an economy. **(10 marks)**
- b) The following data relate to a certain African country.

Item	Value
GNP	8,000,000
Depreciation	100,000
Indirect Business Taxes	80,000
Gross Investment	400,000
Total population	30,000

Consumption	10,000
Personal Income Taxes	800
Excise duty	80
Personal Income	89,000
Net factor incomes from abroad	200,000

Using the above data, calculate:

- i) Net National Product (2 marks)
- ii) GNP per capita (2 marks)
- iii) Net investment (2 marks)
- iv) Disposable personal income (2 marks)
- v) Gross domestic product (2 marks)

QUESTION THREE (20 MARKS)

- a) Explain five factors that determine the level of investment within the country (10 marks)
- b) The per capita income of the country X is twice the per capita income of the country Y. Therefore, the material welfare of the people of country X is double that of country Y. Do you agree? Support your answer (10 marks)

QUESTION FOUR (20 MARKS)

- a) Discuss five tools of monetary policy used by the central bank in your country (10 marks)
- b) Briefly discuss the concept of inflation (2 marks)
- c) Suggest four possible measures that you would implement to contain inflation in Kenya (8 marks)

QUESTION FIVE (20 MARKS)

- a) The commodity market and Money market models of country L is given by;

<i>Commodity market:</i>	$Y = C + I + G$	<i>national income identity</i>
	$C = 100 + 0.9Y^d$	<i>consumption function</i>
	$I = 600 - 30r$	<i>investment function</i>
	$G = 300$	Government expenditure
	$T = \frac{1}{3}Y$	Income tax

Money market:

$$M_{DT} = 0.4Y$$

transaction demand for money

$$M_{DS} = -50r$$

speculative demand for money

$$M_S = 520$$

money supply function

- i) Derive the equations for the IS and LM curves **(6 marks)**
 - ii) Find the equilibrium income and rate of interest **(4 marks)**
- b) Using diagram, illustrate how income flow in an open economy involving all the actors **(10 marks)**