

LAIKIPIA



UNIVERSITY

UNIVERSITY EXAMINATIONS

1ST SEMESTER 2023/2024 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 [14.30-16.30 P.M]

DATE: 11/12/2023

THIS QUESTION PAPER CONSISTS OF FOUR (4) PAGES

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INSTRUCTIONS:

- (i) Answer **Question One** and other **TWO Questions**
- (ii) Write **succinctly** and **legible**

QUESTION ONE

- a) You are given the following data concerning country **J**:

Saving function:	$S = - 30 + 0.3Y^d$
Investment function:	$I = 300$
Government expenditure:	$G = 150$
Tax function:	$T = 100 + 0.2 Y$
Exports:	$X = 250$
Imports function:	$M = 40 + 0.06Y$

Required;

- i) Derive the consumption function **(1 marks)**
- ii) Calculate the equilibrium level of national income. **(3 marks)**
- iii) Compute the government expenditure multiplier and interpret it **(4 marks)**
- iv) How much does the government collect in taxes when the economy is in equilibrium? **(2 marks)**
- v) What is the government's budget deficit or surplus? **(2 marks)**
- b) Explain why imports are subtracted in the expenditure approach to calculating GDP. **(2 marks)**
- c) Briefly explain the two types of exchange rate regimes. **(4 marks)**
- d) Briefly, discuss three measures that a country can instigate to correct a balance of payment deficit **(6 marks)**
- e) Using a well labeled diagrams, explain the following concepts as used in economics;
 - i) Ratchet effect **(3 marks)**
 - ii) The paradox of thrift **(3 marks)**



QUESTION TWO

- a) Differentiate between narrow money (M1) and broad money (M2). **(4 marks)**
- b) Why do people hold money when they can earn interest by lending it to others or by buying interest yielding bonds? **(6 marks)**
- c) Through which instruments does the Central Bank of Kenya control money supply? **(6 marks)**
- d) Explain four factors that can determine the size of a country’s national income **(4 marks)**

QUESTION THREE

- a) What measures would you suggest to control inflation in Kenya? **(8 marks)**
- b) The following is the information from the national income accounts of country K

Particulars	Ksh(Million)
Direct taxes	2,400
Indirect taxes	2,100
Depreciation	2,900
Subsidies	500
Retained corporate profits	450
Social insurance contribution	2,000
Transfer payments to households	3,400
Interest incomes received by households	300
Personal taxes	3,400
Personal savings	1,500
National income	21,200

Required

Compute;

- i) Gross National Product **(2marks)**
- ii) Personal income **(2 marks)**
- iii) Disposable income **(2 marks)**
- iv) Personal consumption spending **(2 marks)**
- c) Graphically derive the IS curve **(4 marks)**



QUESTION FOUR

- a) Explain five factors that determine the level of investment within the country **(10 marks)**
- b) Discuss any three types of unemployment that may exist in an economy. **(6 marks)**
- c) Briefly describe the credit creation process by commercial banks **(4 marks)**

QUESTION FIVE

- a) Using graphs, distinguish between inflationary gap and deflationary gap. **(4 marks)**
- b) The commodity market and Money market models of country **L** is given by;

<i>Commodity market:</i>	$Y = C + I$	<i>national income identity</i>
	$C = 287 + 0.875Y$	<i>consumption function</i>
	$I = 275.5 - 2.5r$	<i>investment function</i>
<i>Money market:</i>	$M_{DT} = 0.26Y$	<i>transactionary demand for money</i>
	$M_{DS} = 10 - 2r$	<i>speculative demand for money</i>
	$M_S = 1000$	<i>money supply function</i>

- i) Derive the equations for the IS and LM curves **(4 marks)**
- ii) Find the equilibrium income and rate of interest **(4 marks)**
- iii) Suppose the government through the central bank of the country reduces the money supply by 4.5%. What will be the new levels of national income and rate of interest? **(4 marks)**
- c) Explain the reasons as to why GNP per capita may not be considered as a good measure of standard of living of a nation. **(4 marks)**

