LAIKIPIA UNIVERSITY

UNIVERSITY EXAMINATIONS

FIRST SEMESTER 2025/2026 ACADEMIC YEAR

THIRD YEAR EXAMINATION FOR THE DEGREE OF SCIENCE IN ECONOMICS & STATISTICS

ECON 314: PUBLIC FINANCE AND FISCAL POLICY

STREAM: ***BSC (ECON STAT)*** ***TIME: 2 HRS***

DAY: WEDNESDAY [11.30 A.M-13.30 P.M] ***DATE: 04/02/2026***

THIS QUESTION PAPER CONSISTS OF THREE (3) PAGES

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INSTRUCTIONS: Answer QUESTION ONE and other TWO QUESTIONS

QUESTION 1

a) Define the following terms as used in the public sector economics
   (i) Quasi-public goods
   (ii) Negative externalities
   (iii) Market failure
   (iv) Non-excludability of a good in consumption **(4 marks)**

b) Consider a local manufacturing firm that emits gas into the air. The Marginal private benefit of this power plant is given by MPB = 50 -2Q. The marginal private costs are given by MPC=20. The marginal damage to the society is given by MD = 1.2 Q.

   Required:
   i) How much output is this power plant going to produce? **(3 marks)**
   ii) What is the socially optimal level of output? **(3 marks)**
   iii) What is the net welfare gain to the society as a result of producing output (ii) compared to (i) above? **(4 marks)**

c) Discuss four rationales for government intervention in private sector activities **(8 marks)**

d) Explain four factors that affect the effective incidence of a tax **(8 marks)**

QUESTION 2

(a) Explain the three types of externalities **(6 marks)**

b) The County Government of Garissa intends to undertake the following two mutually exclusive projects (P_1 and P_2). The table below gives their cash flows and initial costs.

Project	Yearly Cash Flows (USD Millions)					
	0	1	2	3	4	5
P_1	(1,555)	450	590	510	250	205
P_2	(1,861)	500	1,150	650	520	280

Required: Using a rate of return of 10 per cent follow the listed techniques to determine which project should be undertaken.

   i) Net Present Value technique. **(5 marks)**
   ii) Internal rate of return techniques. **(5 marks)**

c) Explain four canons of a good tax system **(4marks)**

QUESTION 3

a) Explain the two main characteristics of public goods **(4marks)**

b) Using a diagram explain the principle of maximum social advantage in allocation of public resources. **(10 marks)**

c) Explain any 3 roles of the National Assembly in the budgetary process in Kenya. **(6marks)**

QUESTION 4

a) Using appropriate diagrams differentiate between efficient provision public and private goods **(8 marks)**

b) Discuss how the government can use the following approaches to correct negative externalities

i) Property rights **(2 marks)**

ii) Actionable pollution permits **(2 marks)**

c) State and explain four causes of market failure. **(8 marks)**

QUESTION 5

(a) Discuss the reasons why most of the developing economies are trapped in debt problems **(10 marks)**

(b) Using appropriate policies explain the following budgetary functions of the government.

i) Allocation **(3 marks)**

ii) Distribution **(3 marks)**

iii) Stabilization **(4 marks)**