KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2016/2017

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF BACHELOR OF ECONOMICS

EAE 201: ECONOMICS OF PUBLIC EXPENDITURE

DATE: Wednesday 17th May 2017 **TIME: 11.00a.m -1.00p.m**

INSTRUCTIONS:

Answer question one (compulsory) and any other TWO questions. Question one carries 30 marks and the rest carry 20 marks each.

Question 1

(a) Suppose that the demand for good Q is by 2 groups and given by;

$Q_1=45-0.2P_1$

$Q_2=15-0.2P_2$

And that the cost function for the same good is given as;

Cost = 4Q

Find the equilibrium levels of prices for each group and quantities for each group when the good is private good and when the good is a public good. Which group will be a free rider and why? (12 marks)

b)) You have been given the following information about an economy.

National income	Ksh 40 million
Exports	Ksh 20 million
Imports	Ksh 30 million
Investment	Ksh 40 million
Autonomous consumption	ksh 20 million
Marginal propensity to consume	0.6
Autonomous tax	ksh 20 million
Marginal propensity to tax	0.01

Using the above information:

(i) Determine the public sector size. 5 marks

(ii) Determine the public sector borrowing requirement 5marks

C) Using appropriate examples explain and differentiate between the following:-

(i) Merit good and Demerit good (4 marks)

(ii)Unanimity Rules and Majority Voting Rules (4 marks)

Question 2

a) Market failure is the main justification why the public sector is necessary in an economy Giving examples, explain four sources of market failure and how the government should intervene to correct the problem. 12 marks

b) Which of the following given goods do you consider public and private goods and why?

10 marks

Good	Type of the good	Reason(s)
Wilderness area-		
Prisons		
Medical School Education		
Public Television Programme		
An internet site providing information on aircrafts schedule		

Question 3

a) List and exhaustively explain five arguments against the government interventions in the economy. 10 marks

b) Giving practical examples, discuss five main reasons for growth of public expenditure (10 marks)

Question 4

(a) Using relevant examples in Kenya discuss the four public policy objective? (8 marks)

(b) With the aid of an appropiate diagram, discuss why government should intervene when a factory producing steel causes a negative externality (12marks)

Question 5

(a) Using appropriate examples explain any five principles of a good budget (10 marks)

(b) If cash flow for a project is as follows

Year	0	1	2	3	4
Benefits	-100000	25000	40000	40000	50000

You are also given that the discount rate is 12 %. Find

(i) The Benefit Cost Ratio and Net Benefit Cost Ratio (8marks)

(ii) Should the investor invest in the project? And why (2 marks)