KASNEB

ATD LEVEL III

PRINCIPLES OF ECONOMICS

MONDAY: 22 May 2017. **Time Allowed: 3 hours.**

Answer any FIVE questions. **ALL questions carry equal marks.**

QUESTION ONE

(a) With the aid of a diagram, explain the backward bending supply curve of labour. (4 marks)

(b) Highlight six assumptions of the law of variable proportions as applied in the theory of production. (6 marks)

(c) Discuss five differences between "monopoly" and "monopolistic" market structures. (10 marks)
(Total: 20 marks)

QUESTION TWO

(a) The following information relate to the quantity consumed of a certain commodity at different price levels and income levels of a consumer.

Quantity (Units)	Price (Sh.)	Income (Sh.)
120	160	60,000
100	180	50,000

Required:

(i) The price elasticity of demand of the commodity. (3 marks)

(ii) The income elasticity of demand of the commodity. (3 marks)

(iii) On the basis of your results in (a)(i) and (a)(ii) above, explain the nature of the commodity. (2 marks)

(b) Citing two relevant examples, explain the term "giffen good". (4 marks)

(c) Summarise eight factors that might lead to a rightward shift of the demand curve. (8 marks)
(Total: 20 marks)

QUESTION THREE

(a) Outline five effects of a price decontrol. (5 marks)

(b) With the aid of a diagram, explain the production possibility frontier. (5 marks)

(c) Developing countries face the challenge of rising external debt that leads to economic stagnation.

(i) State five causes of high external debt in developing countries. (5 marks)

(ii) Outline five economic policies that could be implemented by developing countries to reduce the level of external debt. (5 marks)
(Total: 20 marks)

QUESTION FOUR

(a) Citing relevant examples, distinguish between the terms "leakages" and "injections" as used in national income statistics. (4 marks)

(b) Explain whether the following activities are part of gross domestic product (GDP):

(i) Pensioners do community work for free. (1 mark)

(ii) A supermarket buys products to sell to customers next year. (1 mark)

(iii) Patients who were hurt in a car accident were treated in a hospital. (1 mark)

(iv) Fruits and vegetables were sold in the local market. (1 mark)

(c) The following data relate to the economy of country X:

	Sh.billion
Consumption	620
Investment	230
Government purchases	120
Exports	610
Imports	490

Required:
Gross domestic product (GDP) of country X. (2 marks)

(d) Discuss five determinants of money supply in an economy. (10 marks)
(Total: 20 marks)

QUESTION FIVE

(a) With the aid of well labelled diagrams, explain:

(i) The short-run normal profit of a firm operating in a perfectly competitive market structure. (4 marks)

(ii) The short-run supernormal profit of a firm operating in a perfectly competitive market structure. (4 marks)

(b) Explain four effects of inflation on the key functions of money. (4 marks)

(c) Discuss four differences between commercial banks and non-banking financial institutions. (8 marks)
(Total: 20 marks)

QUESTION SIX

(a) Highlight five limitations of a planned economy. (5 marks)

(b) Outline eight circumstances under which the law of demand is violated. (8 marks)

(c) With the aid of a diagram, explain the shut-down price of a firm in perfect competition. (7 marks)
(Total: 20 marks)

QUESTION SEVEN

(a) Summarise six limitations of using national income statistics in comparing the living standards of two countries. (6 marks)

(b) Outline six objectives of the monetary policy. (6 marks)

(c) A producer of music videos is able to sell the music videos to individual consumers and to television stations. The producer is able to separate the two types of consumers and sell them the same product at different prices.

The following are the demand curves for these two markets:

Television stations: $Q_1 = 420 - 2P_1$

Individual consumers: $Q_2 = 1{,}020 - 4P_2$

The total cost function is given as:

$C = 2{,}000 + 20Q$

$Q = Q_1 + Q_2$

Where:

Q_1 = Quantity demanded by television stations.
Q_2 = Quantity demanded by individual consumers.
P_1 = Price charged to television stations.
P_2 = Price charged to individual consumers.

Required:
The price charged and quantity demanded in each market. (8 marks)
(Total: 20 marks)

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