KASNEB
ATD LEVEL III
PRINCIPLES OF ECONOMICS
PILOT PAPER

September 2015.

Answer any FIVE questions.

Time Allowed: 3 hours.

ALL questions carry equal marks.

QUESTION ONE
(a) Briefly explain five factors affecting the supply of a commodity. (5 marks)
(b) Using appropriate diagrams, distinguish between a stable and unstable equilibrium. (8 marks)
(c) (i) Define the term “Price Elasticity of Demand”.
(ii) Explain any three factors affecting the price elasticity of demand. (5 marks)
(Total: 20 marks)

QUESTION TWO
(a) With reference to the liquidity preference theory, explain three reasons why people demand money. (6 marks)
(b) Highlight four functions of money. (4 marks)
(c) Explain five functions performed by the Central Bank of your country. (10 marks)
(Total: 20 marks)

QUESTION THREE
(a) (i) State the law of diminishing marginal utility. (2 marks)
(ii) Highlight any three assumptions upon which this law is based. (3 marks)
(b) With the aid of a diagram, explain how the consumer’s equilibrium is derived under the indifference curves approach. (5 marks)
(c) Using the indifference curves analysis, distinguish between a “normal good” and an “inferior good”. (10 marks)
(Total: 20 marks)

QUESTION FOUR
(a) Using appropriate examples, distinguish between “fixed costs” and “variable costs”. (4 marks)
(b) Briefly explain four sources of monopoly power in a market. (8 marks)
(c) Using appropriate diagrams, discuss the equilibrium of a firm under perfect competition both in the shortrun and in the longrun. (8 marks)
(Total: 20 marks)

QUESTION FIVE
(a) Explain three main approaches used in the computation of National Income. (6 marks)
(b) The table below represents values of economic transactions for a hypothetical country (figures in billions of shillings).

<table>
<thead>
<tr>
<th>(Sh. billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profits of corporations</td>
</tr>
<tr>
<td>Salaries and wages</td>
</tr>
<tr>
<td>Rent income</td>
</tr>
<tr>
<td>Depreciation</td>
</tr>
<tr>
<td>Indirect taxes</td>
</tr>
<tr>
<td>Subsidies</td>
</tr>
<tr>
<td>Net factor income abroad</td>
</tr>
<tr>
<td>Net interest</td>
</tr>
</tbody>
</table>

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Required:
(i) Gross Domestic Product. (2 marks)
(ii) Net Domestic Product at factor cost. (2 marks)
(iii) Net Domestic Product at market prices. (2 marks)
(iv) Gross National Product. (2 marks)
(v) National Income. (2 marks)

(c) Using appropriate examples, distinguish between “economic growth” and “economic development”. (4 marks)
(Total: 20 marks)

QUESTION SIX
(a) (i) State the law of diminishing returns. (2 marks)
(ii) Using an appropriate diagram, discuss the three stages of production according to this law. (8 marks)

(b) Explain five features of a free market economy as a way of allocating resources among alternative uses. (10 marks)
(Total: 20 marks)

QUESTION SEVEN
(a) Briefly explain four stages of a trade cycle. (8 marks)

(b) The following are economic functions for company ABC Limited:

\[ Q_n = 48 - 2P^2 \]
\[ Q_b = 6P^2 - 8P \]

Where \( P \) represents price and \( Q \) is the quantity.

Required:
(i) Giving reasons, identify the demand curve and the supply curve. (4 marks)
(ii) Determine the price and the quantity at which the market is at equilibrium. (6 marks)

(c) Highlight two economies of scale enjoyed by a firm as a result of large scale production. (2 marks)
(Total: 20 marks)