



CPA PART I SECTION 2

CS PART I SECTION 2

CIFA PART I SECTION 2

CCP PART I SECTION 2

ECONOMICS

TUESDAY: 21 May 2019.

Time Allowed: 3 hours.

Answer any FIVE questions.

ALL questions carry equal marks.

**QUESTION ONE**

- (a) (i) Explain the Keynesian liquidity preference theory of demand for money. (1 mark)
- (ii) Outline five criticisms of the theory in (a) (i) above. (5 marks)
- (b) (i) Distinguish between “perfect oligopoly” and “imperfect oligopoly”. (2 marks)
- (ii) Describe three methods used in fixing prices under the oligopoly market structure. (6 marks)
- (c) Highlight six factors that might lead to a rightward shift of the optimal point of a firm. (6 marks)
- (Total: 20 marks)**

**QUESTION TWO**

- (a) (i) Enumerate five characteristics of a free market economic system. (5 marks)
- (ii) State five advantages of a free market economic system. (5 marks)
- (b) Summarise five factors that could lead to a leftward shift of the supply curve of a commodity. (5 marks)
- (c) The demand and average cost functions of a hypothetical firm are represented by the following functions (in thousands):

$$P = 50 - Q$$

$$AC = \frac{100}{Q} - 16 + 2Q$$

Where: P is the unit price in shillings.  
Q is the quantity of output in units.  
AC is the average cost in shillings.

**Required:**

- (i) The total cost function. (1 mark)
- (ii) The variable cost function. (1 mark)
- (iii) The total profit of the firm when  $Q = 10$  units. (3 marks)

**(Total: 20 marks)**

### QUESTION THREE

- (a) (i) Explain the difference between the “cardinal approach” and the “ordinal approach” to measuring utility. (2 marks)
- (ii) Outline four limitations of the cardinal approach to measuring utility. (4 marks)
- (b) Highlight six factors that determine the effectiveness of trade unions in a society. (6 marks)
- (c) Discuss four applications of elasticity of demand in economic decision making. (8 marks)
- (Total: 20 marks)**

### QUESTION FOUR

- (a) With the aid of a well labelled diagram, explain the equilibrium level of a firm operating under an oligopolistic market structure. (5 marks)
- (b) Summarise five reasons why the prices of agricultural products fluctuate more than the prices of manufactured products. (5 marks)
- (c) Suggest five policy measures that could be adopted by a government to enhance geographical mobility of labour within a country. (5 marks)
- (d) The table below shows the quantity of units produced by a certain firm and the corresponding total cost:

Units produced	Total cost (Sh.“000”)
0	77
2	216
4	235
6	319
8	348
10	382

#### Required:

- (i) The average variable costs when the units produced are 2, 6 and 10 respectively. (3 marks)
- (ii) The marginal costs of production for the 4<sup>th</sup> and 8<sup>th</sup> units respectively. (2 marks)
- (Total: 20 marks)**

### QUESTION FIVE

- (a) Differentiate between “demand deficient unemployment” and “disguised unemployment” as used in economics. (2 marks)
- (b) Enumerate four effects of inflation on the functions of money. (4 marks)
- (c) Outline six limitations of the theory of comparative advantage as used in international trade. (6 marks)
- (d) The following data relate to the consumption function of a hypothetical economy in millions of shillings:

$$C = 300 + 0.6y$$

Where:

C is the consumption function.  
y is the national income.

#### Required:

- (i) The investment function. (1 mark)
- (ii) Discuss seven factors that determine the level of consumption in an economy. (7 marks)
- (Total: 20 marks)**

**QUESTION SIX**

- (a) Examine three roles of foreign exchange reserves in an economy. (3 marks)
- (b) Describe six factors that determine the terms of trade in a country. (6 marks)
- (c) Explain six causes of high levels of external debt in developing countries. (6 marks)
- (d) Analyse five functions of non-banking financial institutions in an economy. (5 marks)

**(Total: 20 marks)**

**QUESTION SEVEN**

- (a) Argue six cases against the use of national income statistics to compare the standards of living between countries. (6 marks)
- (b) With the aid of an appropriate diagram, explain the relationship between the short run average cost curve and the long run average cost curve. (4 marks)
- (c) The following information relates to the commodity and money markets of a certain closed economy in millions of shillings:

**Commodity market**

$$C = 200 + 0.4y$$
$$I = 1,900 - 12r$$

**Money market**

$$M_{DT} = 0.5y$$
$$M_{DS} = 100 - 10r$$
$$M_S = 1,500$$

- Where:
- C = Consumption function
  - y = National income
  - I = Investment function
  - r = Rate of interest
  - $M_{DT}$  = Precautionary and transactionary demand for money
  - $M_{DS}$  = Speculative demand for money
  - $M_S$  = Money supply

**Required:**

- (i) The IS function. (3 marks)
- (ii) The LM function. (3 marks)
- (iii) The equilibrium level of interest rate. (2 marks)
- (iv) The equilibrium level of national income. (2 marks)

**(Total: 20 marks)**

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