QUESTION ONE

a) Differentiate between "microeconomic theory" and "macroeconomic theory". (2 marks)

b) Explain the three basic economic problems. (6 marks)

c) Outline six limitations of a free market economy. (6 marks)

d) The demand and supply of houses in a certain city are represented by the following function (in thousands):

\[ Q_d = 100 - 2P \]
\[ Q_s = 50 + 5P \]

Where: \( Q_d \) is the quantity demanded
\( Q_s \) is the quantity supplied
\( P \) is the rental price per house

Required:

i. The equilibrium price and quantity. (4 marks)

ii. Evaluate the effect of a rental price ceiling set by the rental control board at Sh. 6,500 per house. (2 marks)

(Total: 20 marks)

QUESTION TWO

a) i. Explain the term "elasticity of supply". (1 mark)

ii. Summarise three applications of elasticity of supply in economic decision making. (3 marks)

b) Using a relevant diagram, explain the relationship between the price and quantity demanded of a normal good. (4 marks)

c) Describe three limitations of the cardinal approach of measuring consumer utility. (6 marks)

d) With the aid of a well labeled diagram, discuss the concept of consumer surplus. (6 marks)

(Total: 20 marks)

QUESTION THREE

a) Outline six contributions of industry in the economic development of developing countries (6 marks)

b) Highlight six reasons why most developing have failed to realize the benefits of international trade. (6 marks)

c) Examine eight consequences of unemployment. (8 marks)

(Total: 20 marks)

QUESTION FOUR

a) State five criticisms of the marginal productivity theory of wage discrimination. (5 marks)
b) With the aid of well labeled diagrams, analyse the effects of each of the following situations on wage rate and employment level.

i. **Introduction** of a minimum wage rate by the government (5 marks)

ii. An increase in the school leaving age coupled with a reduction in the retirement age. (5 marks)

iii. A recession in the economy. (5 marks)

*(Total: 20 marks)*

**QUESTION FIVE**

a) Explain three motives of holding money as advanced by the Keynesian liquidity preference theory. (6 marks)

b) With the aid of diagram describe the effect of increase in income to the equilibrium level in the money market. (6 marks)

c) The following information relates to the commodity and money markets of a certain closed in millions of shillings:

\[
\begin{align*}
C &= 300 + 0.6Y \\
I &= 1800 - 10r \\
MDT &= 0.4Y \\
MDs &= 20 - 10r \\
Ms &= 1200
\end{align*}
\]

Where: 
- C=Consumption function
- Y=National Income
- I=Investments function
- r=rate of interest
- MDT=Precautionary and transactionary demand for money
- MDs=Speculative demand for money
- Ms=money supply

Required:

i. The LM Function (2 marks)

ii. The IS Function (2 marks)

iii. The equilibrium level of interest rate (2 marks)

iv. The equilibrium level of national income (2 marks)

*(Total: 20 marks)*

**QUESTION SIX**

a) Describe the effect of inflation on each of the following:

i. Exchange rate (2 marks)

ii. Interest rate (2 marks)

iii. Balance of payments (2 marks)

iv. National income (2 marks)

b) Enumerate four causes of a budget deficit in an economy. (4 marks)

c) Discuss four ways in which a country could finance its public sector expenditure. (8 marks)

*(Total: 20 marks)*
QUESTION SEVEN

a) **Illustrate** the loss making level of output of a firm operating under perfect competition. (5 marks)

b) Outline eight factors that could hinder economic development in developing countries. (8 marks)

c) The following information relates to the national income statistics of a hypothetical economy in billions of shillings:

<table>
<thead>
<tr>
<th>Component</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal income taxes</td>
<td>5,000</td>
</tr>
<tr>
<td>Price index</td>
<td>250</td>
</tr>
<tr>
<td>Undistributed profits</td>
<td>3,000</td>
</tr>
<tr>
<td>Business taxes</td>
<td>4,000</td>
</tr>
<tr>
<td>Transfer payments</td>
<td>8,000</td>
</tr>
<tr>
<td>Social security contributions</td>
<td>11,000</td>
</tr>
<tr>
<td>Subsidies</td>
<td>4,000</td>
</tr>
<tr>
<td>Consumer expenditure</td>
<td>75,000</td>
</tr>
<tr>
<td>Net property income from abroad</td>
<td>1,000</td>
</tr>
<tr>
<td>Taxes on expenditure</td>
<td>18,000</td>
</tr>
<tr>
<td>Depreciation allowance</td>
<td>15,000</td>
</tr>
<tr>
<td>Export of goods and services</td>
<td>36,000</td>
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<tr>
<td>Gross domestic fixed capital formation</td>
<td>24,000</td>
</tr>
<tr>
<td>Government expenditure</td>
<td>28,000</td>
</tr>
<tr>
<td><strong>Import</strong> of goods and services</td>
<td>38,000</td>
</tr>
</tbody>
</table>

**Required:**

i. Gross national product at market price  
ii. Disposable income  
iii. Real gross national product  

(Total: 20 marks)