



MACHAKOS UNIVERSITY

University Examinations for 2021/2022 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

EAE 201: ECONOMICS OF PUBLIC EXPENDITURE

DATE:

TIME:

INSTRUCTIONS:

Answer Question **ONE** and any other **TWO** questions

QUESTION ONE (COMPULSORY) (30 MARKS)

- a) State and explain whether the following statements are True or False. (5 marks)
- i) In the presence of negative production externality too little is consumed.
 - ii) Pareto efficiency is achieved when summation of tax shares is equal to average total cost of producing a public good.
 - iii) When majority voting rule does not provide a consistent social outcome tragedy of commons occurs.
 - iv) Optimal provision of a private good occurs when marginal rate of technical substitution is equal to the ratio of commodity prices.
 - v) Hidden action problem occurs just before a transaction is done.
- b) Using a diagram show how social efficiency is achieved in public provision of a public good. (5 marks)

- c) Distinguish between the following public sector economics terms. (8 marks)
- i) Private discount rate and social discount rate
 - ii) Altruism and warm glow
 - iii) Local public good and club good
 - iv) Productive and unproductive public expenditure
- d) Explain circumstances when shadow pricing should be used in cost benefit analysis. (8 marks)
- e) Clearly explain any four assumptions of median voter theorem. (4 marks)

QUESTION TWO (20 MARKS)

- a) When the invisible hand theorem doesn't hold, government intervention is necessary. Discuss the rationale for government intervention. (8 marks)
- b) Explain six principles that guide public expenditure in any economy. (6 marks)
- c) Explain the limitations of Lindahl pricing. (6 marks)

QUESTION THREE (20 MARKS)

- a) Presence of externalities causes market inefficiency.
- i) Using relevant examples and diagrams explain how positive and negative consumption externalities cause market failure. (8 marks)
 - ii) Identify and discuss the alternative methods of dealing with externalities. (4 marks)
- b) Distinguish between Rostow-Musgrave theory and Wagner's organic state theory of public expenditure. (8 marks)

QUESTION FOUR (20 MARKS)

- a) Write brief notes on the following public sector economics concepts
- i) Moral hazard (4 marks)
 - ii) Lindahl pricing (4 marks)
 - iii) Efficiency in production-mix (4 marks)
 - iv) Theory of second best (4 marks)
 - v) Median voter theorem (4 marks)

QUESTION FIVE (20 MARKS)

- a) The growth of public expenditure is a major policy issue to many countries, especially Kenya. Explain any six causes of public expenditure growth in Kenya. (6 marks)
- b) Explain any four ways of measuring the size of public sector. (4 marks)
- c) Explain instances of government failure in your country. In your view what is the remedy to this? (10 marks)