



MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

EAE 201: ECONOMICS OF PUBLIC EXPENDITURE

DATE: 11/8/2021

TIME: 11.00-1.00 PM

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)
- Lindahl pricing is a system where individuals policy options are put into a vote and the best policy chosen.
 - Tragedy of commons occurs when there is imperfect information in the market.
 - Invisible hand theorem is applied on situations where pareto efficient marginal conditions are not met.
 - Optimal provision of public goods occurs when sum of tax shares is equal to average cost of producing them.
 - In presence of positive consumption externality too much is produced.
- b) Using a relevant example explain how Condorcet paradox occurs. (5 marks)
- c) Distinguish between first fundamental theorem of welfare economics and pareto optimality. (4 marks)
- d) Abandonment of Laissez-fair doctrine has led to non-market failure.
- Explain six causes of non-market failure in your country. (6 marks)
 - In your own view how can non-market failure be corrected? (4 marks)
- e) The goal of the government is to ensure the efficient allocation of resources to both public and private goods. However, in provision of public goods some problems emerge. Explain. (6 marks)

QUESTION TWO (20 MARKS)

- a) Presence of externalities causes market inefficiency.
 - i. Using relevant examples and diagrams explain how positive and negative production externalities cause market failure. (8 marks)
 - ii. Identify and discuss the alternative methods of dealing with externalities. (4 marks)
- b) Explain any four types of public budgets you know. (8 marks)

QUESTION THREE (20 MARKS)

- a) Explain any six limitations of cost-benefit analysis (CBA) as a method of evaluating public projects. (6 marks)
- b) When the first fundamental theorem of welfare economics doesn't hold, government intervention is necessary. Discuss the rationale for government intervention. (10 marks)
- c) In private provision of public goods free rider problem may occur. Define free rider problem and explain ways in which this private provision problem may be solved. (4 marks)

QUESTION FOUR (20 MARKS)

Write brief notes on the following public sector economics concepts

- a) Median voter theory (5 marks)
- b) Wagner's organic state theory (5 marks)
- c) Efficiency in production (5 marks)
- d) Adverse selection (5 marks)

QUESTION FIVE (20 MARKS)

- a) The growth of public expenditure is a major policy issue to many countries, especially Kenya. Explain the seven effects of public expenditure growth in Kenya. (7 marks)
- b) Explain the determinants of political equilibrium. (5 marks)
- c) Using a diagram show how social efficiency is achieved in public provision of a public good. (8 marks)