



MACHAKOS UNIVERSITY

University Examinations for 2022/2023 Academic Year

SCHOOL OF BUSINESS, ECONOMICS AND HOSPITALITY AND TOURISM

MANAGEMENT

DEPARTMENT OF ECONOMICS

SECOND YEAR FIRST SEMESTER EXAMINATION FOR

BACHELOR OF ECONOMIC 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) Lindahl equilibrium is attained when summation of society's MRS is equal to marginal cost.
 - (ii) Pareto efficiency is achieved when summation of tax shares is equal to average total cost of producing a public good.
 - (iii) Pigouvian taxes can be utilized to control free rider problem.
 - (iv) When the first fundamental theorem of welfare economics doesn't hold free market system is necessary.
 - (v) Condorcet rule applies when invisible hand theorem does not hold.
- b) The Arrow's Impossibility Theorem states that a rule for collective decision in a democratic society must meet certain requirements: Discuss. (6 marks)

- c) Explain the social efficiency of public provision of a good using a diagram. What are the challenges with government supply of public goods? (6 marks)
- d) Presence of externalities causes market inefficiency. Using relevant examples and diagrams explain how positive consumption and production externality causes market failure. What alternatives exist to address these externalities. (9 marks)
- e) 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 TWO (20 MARKS)

- a) Write short notes on the following theories of public expenditure. (9 marks)
- i. Rostow-Musgrave theory
 - ii. Wagner's organic state theory
 - iii. The Peacock and Wiseman's Political Constraint theory
- b) A budget may be defined as a financial plan, which outlines the major sources of revenue and how the money raised is to be used or shared amongst competing needs. Discuss four principles of a good public budget. (8 marks)
- c) Explain three circumstances when shadow pricing should be used in cost benefit analysis. (3 marks)

QUESTION THREE (20 MARKS)

- a) Using relevant diagrams explain efficiency in consumption. How is this marginal condition met in a perfectly competitive market? (8 marks)
- b) Explain the limitations of Lindahl pricing. (4 marks)
- c) Government action is necessary if the invisible hand theorem and first fundamental theorem of welfare economics fails to hold. Discuss the rationale for government intervention. (8 marks)

QUESTION FOUR (20 MARKS)

- a) Many nations, including Kenya, find the growth of public expenditure to be a significant issue of policy.
- i. Explain any six consequences of public expenditure growth in Kenya. (6 marks)

- ii. Explain possible ways of controlling the growth of public expenditure in Kenya. (4 marks)
- b) Explain five instances of government failure in your country. In your view what is the remedy to this? (8 marks)

QUESTION FIVE (20 MARKS)

- a) Write brief notes on the following public sector economics concepts
 - (i) Adverse selection (4 marks)
 - (ii) Condorcet paradox (4 marks)
 - (iii) Lindahl pricing (4 marks)
 - (iv) Efficiency in output composition (4 marks)
 - (v) Median voter theorem (4 marks)