



MACHAKOS UNIVERSITY

University Examinations for 2020/2021 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR

BACHELOR OF ECONOMICS AND STATISTICS

BACHELOR OF ECONOMICS AND FINANCE

BACHELOR OF ECONOMICS

EAE 201: ECONOMICS OF PUBLIC EXPENDITURE

DATE: 24/3/2021

TIME: 2.00-4.00 PM

INSTRUCTIONS:

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

QUESTION ONE (COMPULSORY) (30 MARKS)

- a) Market failure occurs when Despite the efforts made by governments of developing countries in the efficient allocation of resources, Pareto efficiency has not been achieved.
- i. Discuss five causes for government failure in your country. (10 marks)
 - ii. In your own view how can government failure be corrected? (4 marks)
- b) Under what circumstances are private market forces likely to solve the free rider problem? (6 marks)
- c) Explain the three conditions for Pareto efficiency. (6 marks)
- d) Distinguish between the following concepts (4 marks)
- i. Crowding out and horse trading
 - ii. First theorem of welfare economic and second theorem of welfare

QUESTION TWO (20 MARKS)

- a) The size of public sector refers to the degree of participation by the government in provision of goods and services within the economy. Explain any three ways of measuring public sector size. (6 marks)
- b) When the invisible hand doesn't work and the first fundamental theorem of welfare economics doesn't hold government intervention is necessary. Discuss the rationale for government intervention. (10 marks)
- c) Explain the reasons why the budget may be presented in parts. (4 marks)

QUESTION THREE (20 MARKS)

Write notes on the following concepts

- a) Arrow's impossibility theorem (5 marks)
- b) Theory of the second best (5 marks)
- c) Adverse selection (5 marks)
- d) Moral hazard (5 marks)

QUESTION FOUR (20 MARKS)

- a) i. Presence of externalities causes market inefficiency. Using examples distinguish between negative and positive externalities and explain how they cause market inefficiency. Use examples and diagrams. (8 marks)
- ii. Identify and discuss the alternative methods of dealing with externalities. (4 marks)
- b) Discuss the principles that guide the public expenditure in any economy. (8 marks)

QUESTION FIVE (20 MARKS)

- a) The growth of public expenditure and public sector in developing countries is a major problem whether developed or less developed. Discuss the causes of this growth. (10 marks)
- b) Explain the challenges associated with annual budgeting in Kenya. (5 marks)
- c) Define public goods and state the problems associated with public goods provision. (5 marks)