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**KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY**

UNIVERSITY EXAMINATION, 2024/2025ACADEMIC YEAR

FOURTH YEAR, SECOND SEMESTER EXAMINATION

FOR THE DEGREE OF BACHELOR OF SCIENCE

(BUSINESS ADMINISTRATION)

Date: 12th August, 2024

Time: 8.30am –10.30am

# KBM 2406 INTERNATIONAL ECONOMICS 11

**INSTRUCTIONS TO CANDIDATES**

ANSWER **QUESTION ONE (COMPULSORY)** AND **ANY OTHER TWO** QUESTIONS

## QUESTION ONE (30 MARKS)

**Impact of Aid Fund in Kenya**

The foreign exchange (forex) market is a global decentralized market for trading currencies, crucial for conducting international trade and investment. Central Bank of Kenya (CBK), commercial banks, forex bureaus, multinational corporations, and retail traders. The Kenyan Shilling (KES) is traded against major currencies like the US Dollar (USD), Euro (EUR), and British Pound (GBP). The KES/USD exchange rate fluctuates based on supply and demand, influenced by factors like trade flows, remittances, and foreign direct investment (FDI). The CBK occasionally intervenes in the forex market to stabilize the currency and control inflation. For example, in 2020, the Kenyan Shilling depreciated against the US Dollar due to decreased tourism and export earnings amidst the COVID-19 pandemic (Central Bank of Kenya, 2021). The balance of payments (BOP) is a record of all economic transactions between residents of a country and the rest of the world over a period.

The current Account includes trade in goods and services, income, and current transfers. Kenya typically runs a current account deficit due to higher imports than exports. The Capital and Financial Account contains records capital transfers, FDI, portfolio investment, and other financial flows. Key exports include tea, coffee, and horticultural products, while imports consist of machinery, petroleum products, and vehicles. A significant source of foreign exchange, contributing to the current account which attracted to sectors like manufacturing, real estate, and information technology. For instance; in 2020, Kenya's current account deficit widened due to increased imports of medical supplies and lower export earnings (World Bank, 2021).The IMF is an international organization that aims to promote global monetary cooperation, secure financial stability, facilitate international trade, and reduce poverty. The IMF programs Kenya has engaged with the IMF through various programs, including the Extended Credit Facility (ECF) and Stand-By Arrangement (SBA). These programs aim to support economic reforms, enhance fiscal management, and stabilize the economy. The institution gives financial support and policy advice such as in 2021, Kenya received a $2.34 billion loan under the ECF and SBA to help address the economic impact of COVID-19 and support structural reforms (IMF, 2021) and the institution also provides policy recommendations on issues like tax policy, public debt management, and monetary policy.

The institution has undertaken reforms in the financial sector such as the IMF-supported programs have prompted Kenya to implement fiscal consolidation measures, enhance revenue collection, and improve public financial management. Regional economic integration involves the process of countries in a geographic region cooperating to reduce trade barriers and increase economic interaction. Kenya is a member of the EAC, which aims to achieve economic integration through a common market, customs union, and monetary union. Common Market allows free movement of goods, services, capital, and labour among member states while Customs Union harmonizes external tariffs and removes internal tariffs on goods traded within the region. There are a number of benefits are trade expansion, regional integration has expanded Kenya's trade with neighbouring countries like Uganda, Tanzania, and Rwanda. On the other hand, Investment Opportunities have also increased economic cooperation attracts investment into the region, fostering industrialization and infrastructure development.

a) The case study has demonstrated a disequilibrium in interest rates and income level. IS-LM curves are used to determine equilibrium interest rates and income level in the economy. Discuss factors that may shift the IS-curve of the EAC countries citing relevant examples (6 marks)

b) Various exchange rate regimes are illustrated in the case study. Assume further that Kenya operates different exchange rate regimes to determine her exchange rate with her trading partners. Discuss these exchange rate regimes giving relevant examples in each case base your argument in the above case (6 marks)

c) The case study have shown that Kenya trade with other countries and the transactions are recorded in books of accounts that determines the status of Balance of Payment. Discuss in details the components of BOP. (6 Marks)

d) International Monetary Fund (IMF) has been singled out as one of the financial institutions that advance loans to developing countries and is also known for its olive branch to countries indented in debts, however, there are certain criticism against the organization. Discuss these criticisms against IMF giving relevant examples. (6 Marks)

e) Economic integration has advances economic development in Africa allowing African countries to undergo various economic integrations to enhance trade amongst themselves and with other countries of the world. Explain five stages of economic integration that Africa countries have undergone (6 marks)

**QUESTION TWO (20 MARKS)**

a) Describe how exchange rates between different currencies are determined. (6 marks)

b) The concepts of the law of one price and the purchasing power parity are used to explain changes in exchange rates. Discuss this statement in details with the help of numerical illustrations. (6 Marks)

c) Clearly explain the following terms as used in international economics:
   i) Frictionless price
   ii) Hard money
   iii) Appreciation
   iv) Holding short position (8 marks)

**QUESTION THREE (20 MARKS)**

a) Explain the covered interest arbitrage using a numerical example.

(8 marks)

b) Whenever covered interest parity does not hold, there are opportunities to make risk- less profit through interest arbitrage. Discuss this statement in relation to the activities of arbitrageurs in bringing the foreign exchange and financial markets into equilibrium

(7 marks)

c) Explain the main features that distinguished the gold-exchange standard from the gold standard

(5 marks)

**QUESTION FOUR (20 MARKS)**

a) Kenya has never recorded a positive balance of trade since independence in 1963. Explain why this is the case and how the country has managed to fulfil its international obligations.

(8 marks)

b) One of the provisions of Bretton Woods Agreement was designed to tackle the balance of payment (BOP) problems. Write a brief description of the tool that was designed to tackle this problem (4 marks)

c) One of the key stages of economic integration is creation of a customs union. Explain the dynamic welfare effects due to creation of a customs union. (8 marks)

**QUESTION FIVE (20 MARKS)**

a) The establishment of the new international monetary system adopted the American plan rather than the British plan. Explain what the British plan advocated for

(8 marks)

b) Explain the protectionism tools used in the USA Trade Agreement Act.

(6 Marks)

c) Describe the guidelines that should be followed when establishing a Zollverein

(6 marks)