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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY

UNIVERSITY EXAMINATION, 2024/2025ACADEMIC YEAR
FIRST YEAR, SECOND SEMESTER EXAMINATION
FOR THE DEGREE OF BACHELOR OF SCIENCE
(BUSINESS ADMINISTRATION)

Date: 10th December, 2024
Time: 2.30pm –4.30pm

KFI 2102 - PRINCIPLES OF MACRO ECONOMIC THEORY

INSTRUCTIONS TO CANDIDATES

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

QUESTION ONE (30 MARKS)

ECONOMIC GROWTH AND MACROECONOMIC DYNAMICS IN COUNTRY X

Country X is a small open economy in Sub-Saharan Africa with a population of 20 million. Over the past decade, it has experienced moderate economic growth, primarily driven by agriculture, manufacturing, and foreign direct investment (FDI). Recently, the government has been focusing on increasing national income through infrastructure development, attracting more foreign investments, and encouraging domestic consumption. However, the country faces several challenges, including fluctuating global commodity prices, limited domestic savings, and a widening current account deficit. With increasing imports of machinery and consumer goods, coupled with high demand for foreign capital, managing the national income and promoting balanced growth has become a priority for policymakers.

Country X's Gross Domestic Product (GDP) has been growing at an average annual rate of 4.5%, primarily fueled by strong agricultural exports and remittances from citizens working abroad. Despite this growth, the country's per capita income remains low, and income inequality is a pressing issue. In recent years, the government has made significant public investments in infrastructure, such as roads, energy, and water projects, to boost productivity. These investments are financed by a mix of domestic resources and external borrowing. As a result, public debt has increased to 60% of GDP, raising concerns about the sustainability of such investment-driven growth.Household consumption accounts for about 65% of Country X's GDP.

However, consumption is unevenly distributed across income levels, with wealthier households consuming more imported goods, while low-income households primarily consume domestically produced goods. There has been an increase in demand for imported electronics, vehicles, and luxury goods, contributing to the growing trade deficit.

Despite the government's efforts to boost domestic industries and create jobs, the high cost of living and slow wage growth have constrained household consumption. Moreover, the agricultural sector, which employs a significant portion of the population, remains vulnerable to weather conditions and global price volatility. Domestic investment in Country X is around 20% of GDP, but domestic savings remain low, at just 10% of GDP. This has led to a reliance on foreign direct investment (FDI) and external borrowing to finance both public and private investments. Foreign investors are particularly interested in the country's growing manufacturing sector and natural resources. However, the gap between domestic savings and investment has resulted in a current account deficit, which has been widening in recent years.

To attract more FDI, the government has introduced tax incentives and relaxed regulations, but this has not yet resulted in a significant increase in domestic production or job creation. Country X is highly integrated into the global economy, relying on exports of agricultural products (such as coffee, tea, and flowers) and manufactured goods. However, imports of capital goods, machinery, and consumer goods have outpaced exports, leading to a persistent trade deficit of 8% of GDP. The country has signed several free trade agreements (FTAs) with neighboring countries and international trade blocs, hoping to boost exports. However, its reliance on primary commodities and limited value addition in manufacturing have constrained its ability to fully benefit from these trade agreements.

Required;

Use the case study to answer the questions that follow;

a) Country X has experience steady increase in consumption over the years. Discuss factors that have contributed to this

(6 marks)

b) The country has implemented macroeconomic policies to ensure sustainable economic growth. Explain macroeconomic goals Country X seeks to achieve by implementing policies in the economy.

(6 marks)

c) The country has received Foreign Direct Investment (FDI) to undertake both public and private investment. Discuss other factors that could have influenced the level of investment in the country

(8 marks)

d) Country X has improve infrastructure to achieve certain level of economic growth (GDP) through the multiplier effect, however, this has not been realized due to limitations of the multiplier effect. Discuss factors that limit application of multiplier to enhance economic growth**.**

(6 marks)

e) Explain the following economic terminologies as applied in Country X in the case

i) Gross Domestic Product and Gross National Product

(2 marks)

ii) Intended investment and unintended investment

(2 marks)

QUESTION TWO (20 MARKS)

a) Kenya is currently facing high rate of youth unemployment that has led to slow growth of output. Explain four types of unemployment that Kenyan youths face in the economy today

(8 marks)

b) The following data relates to a developing economy in Africa. Use it to answer the questions that follow;

Item	**value (000) KSHS**
GNP	8,000,000
Depreciation	100,000
Indirect business taxes	80,000
Gross investment	400,000
Total population	30,000
Consumption	10,000
Personal income taxes	800
Excise duty	80
Personal income	89,000
Net factor income from abroad	200,000

i) Net National Product **(2 marks)**
ii) GNP per capita **(2 marks)**
iii) Disposable personal income **(2 marks)**
iv) Gross domestic product **(2 marks)**

c) Kenyan economy experiences balance of payment problems. Explain two factors that cause a shift to the right in the balance of payment curve **(4 marks)**

QUESTION THREE (20 MARKS)

a) Using well-explained points, discuss why per capita income is not a good measure of social welfare **(8 marks)**

b) Assume that your county has been hit hard by a calamity that has affected the level of investment. Discuss some of the factors that will determine the level of investment in the county during and post calamity **(8 marks)**

c) The table below shows recent population and labour force data for a developing country in Africa.

Total population (millions)	22 300 000
Civilian population (over 18 years)	18 099 700
Labour force	11 819 500
Employed persons	11 212 300

Based on the information above, calculate the unemployment rate and the labour participation rate. **(4 marks)**

QUESTION FOUR (20 MARKS)

a) Most developing countries in Africa face growth constraints leading to slow economic growth in Africa. Discuss any five factors that contribute to economic growth in developing countries.

(4 marks)

b) The following equations describe a certain economy

$C = 300 + 0.85Y^d \longrightarrow$ Consumption function

$I = 300 - 200r \longrightarrow$ Investment function

$T = 70 + 0.2Y \longrightarrow$ Tax function

$G = 100 \longrightarrow$ Government expenditure

$X = 10 \longrightarrow$ Exports

$M = 150 + 0.06Y \longrightarrow$ Import function

$M^s = 4000 \longrightarrow$ Money supply

$M^D = 0.2Y - 10r \longrightarrow$ Money demand

Determine;

i) IS equation **(3 marks)**

ii) LM equation **(3 marks)**

iii) Level of interest rates and income level at which the economy is at both the good market and money market are at equilibrium **(4 marks)**

c) In the recent past, the demand for goods and services in the economy has been found to increase implying a rise in consumption rate. Explain factors that have contributed to this increase

(6 marks)

QUESTION FIVE (20 MARKS)

a) Suppose you have been offered an internship position in one of the government ministry and your supervisor has asked you to prepare a speech on how to curb inflation rate in the economy. What measures would you recommend to the government to implement in order to control inflation rate in Kenya?

(8 marks)

b) Mercy not the real name was walking home after classes and comes across a piece of paper which looks like money. Discuss properties the student will look at in order to appreciate that the piece paper is money

(6 marks)

c) Most countries face inaccurate reporting of the national income figures due to difficulties in measurement. Explain the difficulties experienced when measuring National Income

(6 marks)