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**GARISSA UNIVERSITY**

**UNIVERSITY EXAMINATION 2020/2021 ACADEMIC YEAR FOUR**

**SECOND SEMESTER EXAMINATION**

**SCHOOL OF BUSINESS AND ECONOMICS**

**FOR THE DEGREE OF BACHELOR OF BUSINESS MANAGEMENT**

**COURSE CODE: ACS 423**

**COURSE TITLE: PRINCIPLES OF ECONOMICS II**

**EXAMINATION DURATION: 2 HOURS**

**DATE: 08/04/2021 TIME: 09.00-11.00 AM**

**INSTRUCTION TO CANDIDATES**

* **The examination has FIVE (5) questions**
* **Question ONE (1) is COMPULSORY**
* **Choose any other TWO (2) questions from the remaining FOUR (4) questions**
* **Use sketch diagrams to illustrate your answer whenever necessary**
* **Do not carry mobile phones or any other written materials in examination room**
* **Do not write on this paper**

**This paper consists of THREE (3) printed pages *please turn over***

**QUESTION ONE (COMPULSORY)**

Case Study

**Water, Water, Everywhere**

Centuries ago, economists puzzled over the price of diamonds relative to the price of water. Diamonds are mere baubles— certainly not a necessity of life in any sense. Water is essential to life and has hundreds of valuable uses. Yet diamonds are expensive, while water is cheap. For example, the $10,000 spent on a one-carat diamond could instead buy about 10,000 bottles of water or about 4 million gallons of municipally supplied water (which typically sells for about 25 cents per 100 gallons). However measured, diamonds are extremely expensive relative to water. For the price of a one-carat diamond, you could buy enough water to last a lifetime.

How can the price of something as useful as water be so much lower than something of such limited use as diamonds? In 1776, Adam Smith discussed what has come to be called the diamonds-water paradox. Because water is essential to life, the total utility derived from water greatly exceeds the total utility derived from diamonds. Yet the market value of a good is based not on its total utility but on what consumers are willing and able to pay for an additional unit—that is, on its marginal utility. Because water is so abundant in nature, we consume water to the point where the marginal utility of the last gallon purchased is relatively low. Because diamonds are relatively scarce compared to water, the marginal utility of the last diamond purchased is relatively high. Thus, water is cheap and diamonds expensive. As Ben Franklin said “We will only know the worth of water when the well is dry.”

Speaking of water, sales of bottled water doubled in the United States between 1997 and 2002—growing faster than any other beverage category—creating an $8.5 billion industry. The United States offers the world’s largest market for bottled water—importing water from places such as Italy, France, Sweden, Wales, even Fiji. “Water bars” in Boston, New York, and Los Angeles offer bottled water as the main attraction.

Why would consumers pay a premium for bottled water when they can drink from the tap for virtually nothing? First, many people do not view the two as good substitutes. Some people have concerns about the safety of tap water, and they consider bottled water a healthy alternative (about half those surveyed in a Gallup Poll said they won’t drink water straight from the tap). Second, even those who drink tap water find bottled water a convenient option away from home. According to the theory of utility maximization, people who buy bottled water apparently feel the additional benefit offsets the additional cost. Bottled-water sales threaten the soft-drink industry. Fast food restaurants now offer bottled water as a healthy alternative to soft drinks. McDonald’s, for example, is test marketing a “Go Active Happy Meal” that includes a bottle of water. But if you can’t fight them, join them: Pepsi’s Aquafina is the top-selling U.S. brand of bottled water, and Coke also has its own brand, Dasani.

Required

1. What is the diamonds-water paradox, and how is it explained? **[4Marks]**

ii Use the same reasoning to explain why bottled water costs so much more than tap water.

**[3Marks]**

**(b).**The demand and supply schedules for carrots in a certain market are given below:

Price per ton Quantity demanded per month Quantity supplied per month

(Sh. ‘000’) (Thousands of tons) (Thousands of tons)

2 110.0 5.0

4 90.0 46.0

8 67.5 100.0

10 62.5 115.0

12 60.0 122.5

Determine the equilibrium quantity and price by graphical method. **[6 marks]**

**(c).** Define the concept of “**national income**”. **[2 marks]**

**(d).** Discuss the view of the classical and neo-classical economists on the transition from microeconomics to macroeconomics. **[4Marks]**

(e). List and explain importance of microeconomics and macroeconomics. **[2Marks]**

(f). Discuss in details the importance of macroeconomics. **[2Marks]**

(g). Write short note on the following:

1. Gross Domestic Product
2. Gross National Product
3. Net National Product
4. Domestic Product
5. Personal Income
6. Disposable Income
7. Nominal Vs Real Gross Domestic Product  **[7Marks]**

**QUESTION TWO [20Marks]**

1. Present the circular flow of income and expenditure in a simple closed economy. Show how such a flow provides a basis for the three approaches to national income accounting.**[10Marks]**
2. Distinguish carefully between the multiplier and the accelerator. How do the two interact in the determination of the level of economic growth and development in your country?

**[10Marks]**

**QUESTION THREE [20Marks]**

1. Discuss the nature and determinants of aggregate demand in a given market. **[14Marks]**
2. Using suitable examples of commodities, explain how a reverse demand curve can be derived. **[6Marks]**

**QUESTION FOUR [20Marks]**

1. Differentiate between fiscal and monetary policies and show how the two policies are used to influence the economy. **[10 Marks]**
2. Assess the success of implementing the two policies in developing countries. **[10Marks]**

**QUESTION FIVE [20Marks]**

1. Clearly explain the processes which lead to deficits in the balance of payments and steps which may be taken to reverse such processes.  **[14Marks]**
2. What are the major causes of unemployment in Kenya?  **[6Marks]**