CHUKA   **UNIVERSITY**

UNIVERSITY EXAMINATIONS

EXAMINATION FOR THE AWARD OF MASTR OF SCIENCE IN ECONOMICS

MSEC 852: PUBLIC SECTOR ECONOMICS

STREAMS: MSC (ECON)   **TIME: 3 HOURS**

DAY/DATE: TUESDAY 06/04/2021   **8.30 A.M. – 11.30 A.M.**

INSTRUCTIONS: Answer question ONE and any other TWO questions

QUESTION ONE

(a) With reference to the micro model of public expenditure growth, show how exhaustive public expenditure can be influenced by the following

      (i) A deterioration of the service environment   [3 marks]

      (ii) The rise in the price (cost) of the public sector inputs relative to private sector inputs   [3 marks]

      (iii) An improvement in the quality of public service   [3 marks]

      (iv) An increase in the economy's total tax base   [3 marks]

(b) Explain the factors that influence tax incidence   [10 marks]

(c) Explain the main reasons why public sector is required by the economies   [8 marks]

(d) Most East African countries, borrowing spree has increased the accumulation of new debts with signs that these countries capacity to repay loans could be impaired, eventually leading to debt crisis. As an economist, suggest ways that are necessary to solve this problem.

                                       [10 marks]

(e)   Suppose an economy is populated with only two people, Grace and John. They gain   utility from consuming a private good bread (b) and public good park (Z), let Grace and John's utility functions be;

$$U_G = b_G + 30Z$$

$$U_J = (b_j)^{\frac{1}{3}} Z^{\frac{2}{3}}$$

Assuming the economy is endowed with one acre of scarce resource land, and one unit   of land allocated to farming produces 100 leaves of bread. What is the Pareto optimal   allocation in which Grace's utility is fixed.   [10 marks]

QUESTION TWO

(a)   Distinguish between tax evasion and tax avoidance   [2 marks]

(b)   Explain the 6 main causes of tax evasion and avoidance in your country.   [6 marks]

(c)   With aid of diagram discuss eh Simple Tax Evasion model (positive theory of tax evasion) briefly explaining its useful insights. Highlight its potential weaknesses.

[17 marks]

QUESTION THREE

(a)   The overall goal of centralization is to bring efficiency in the allocation of resources in   the economy because a system of decentralized governments might lead to an inefficient allocation of resources. Give reasons for centralization.   [10 marks]

(b)   Discuss the Tiebout Model of fiscal federalism explaining clearly the assumptions and   its disadvantages.   [15 marks]

QUESTION FOUR

(a)   Government can finance its budget deficit by either increasing taxation or borrowing. Is
         borrowing better than taxing? Explain   [10 marks]

(b)   Discuss the following models of public debts

         (i)   Lerner's view   [5 marks]

         (ii)   An overlapping Generations Model   [5 marks]

         (iii)   Ricardian model   [5 marks]