

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

ECONOMIC ENVIRONMENT – PAPER 2

CPA(U) EXAMINATIONS

JUNE 2001

INSTRUCTIONS TO CANDIDATES:

1. Time allowed: **3 hours**
2. Attempt **all** questions in Section A and any **four** questions from Section B.
3. Section **A** has twenty compulsory questions each carrying 2 marks.
4. Section **B** has **six** questions and only **four** are to be attempted. Each question carries 15 marks.
5. Please, read further instructions on the answer book.

SECTION A

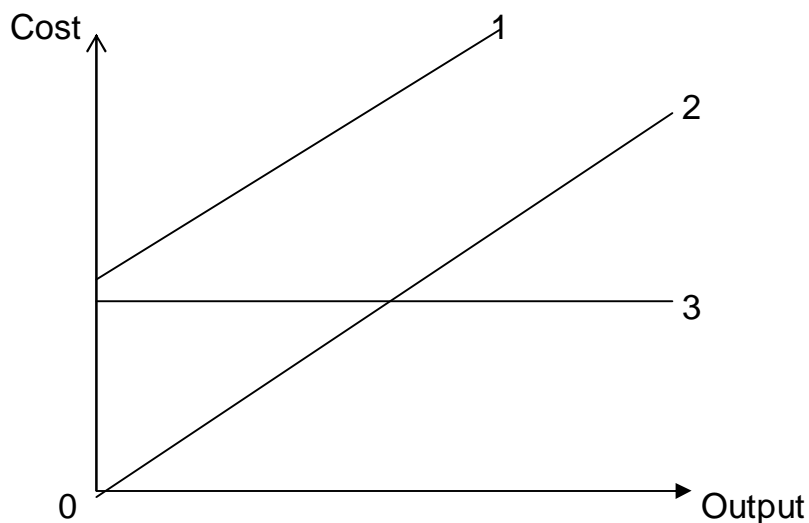
Question 1:

- (i) Market demand is:-
 - (a) The sum of all individual demands.
 - (b) Demand at prevailing average prices.
 - (c) Ability to pay the market price.
 - (d) Demand in a perfectly free market.
- (ii) The “income effect” of a rise in the price of a commodity is the:-
 - (a) Increase in the price of substitute commodities.
 - (b) Increase in the consumer’s purchasing power.
 - (c) Decrease in the short-term demand for the commodity.
 - (d) Fall in the consumer’s purchasing power.
- (iii) The marginal propensity to consume is a measure of:-
 - (a) The marginal utility of money to the average consumer.
 - (b) The proportion of extra income spent on consumer goods.
 - (c) The rate of consumption of commodities with an elastic demand.
 - (d) The marginal utilities of those consumer goods bought by the average family.
- (iv) The essence of regressive taxation is that the tax takes from a person:-
 - (a) An equal proportion of his earned and unearned income.
 - (b) A high proportion of his earned income only.
 - (c) A diminishing proportion of his income as that income increases.
 - (d) An increasing proportion of his income as that income increases.
- (v) The consumer allocates limited resources among a large number of competing wants in order to achieve:-
 - (a) Optimum opportunity cost.
 - (b) Average opportunity cost.
 - (c) Freedom of exchange.
 - (d) Maximum satisfaction.

- (vi) A claim for higher wages would not be helped by an increase in:-
- (a) Unemployment.
 - (b) Labour productivity.
 - (c) Consumer's demand.
 - (d) Profit.
- (vii) When a Kenyan newspaper company cut the price of one of its newspapers from Shs.45/= to Shs.30/=-, it claimed that its sales rose by 33%.

What is the price elasticity of demand for this price change?

- (a) 0.4.
 - (b) 1.0.
 - (c) 1.5.
 - (d) 2.3.
- (viii) Which condition defines economic efficiency in production?
- (a) All factors of production are fully employed.
 - (b) All firms are producing at their profit maximising levels of output.
 - (c) Output of any one good cannot be increased without reducing the output of some other goods.
 - (d) There are no further opportunities for substituting capital for labour.
- (ix) The diagram below shows various costs of a firm producing different levels of output in the short run.



How should the curves be labeled?

Curve 1	Curve 2	Curve 3
a) Total Cost	total fixed cost	total variable cost
b) Total cost	total variable cost	total fixed cost
c) Total fixed cost	total variable cost	total cost
d) Total variable cost	total cost	total fixed cost

- (x) Which of the following situations is an example of technological unemployment?
- (a) A period of wet weather forces building firms to declare workers redundant.
 - (b) A decline in world trade causes export-oriented firms to reduce the size of their labour force.
 - (c) The imposition of a tax on clothes forces tailoring firms to make some employees redundant.
 - (d) A firm introduces electric typewriters and reduces the number of typists employed by 25%.

Use the following measures employed to control inflation to answer questions (xi) – (xiii):-

- (i) A higher rate of corporation tax.
 - (ii) An increase in interest rates.
 - (iii) A restriction on money supply in the economy.
 - (iv) A higher rate of sales tax.
 - (v) A reduction in government expenditure.
 - (vi) An increase in the rate of income tax.
 - (vii) Wage controls.
- (xi) Which of the above are fiscal measures?
- (a) (i), (ii), (iii), (iv).
 - (b) (i), (iii), (v), (vi).
 - (c) (i), (iv), (v), (vi).
 - (d) (ii), (iv), (v), (vi).

(xii) Which of the above are monetary measures?

- (a) (i), (ii).
- (b) (ii), (iii).
- (c) (i), (iii).
- (d) (ii), (v).

(xiii) Which of the above would be most suitable for reducing cost push inflation?

- (a) (ii).
- (b) (iii).
- (c) (v).
- (d) (vii).

(xiv) The following is a list of the main costs incurred by a firm:-

- (i) Rent of buildings.
- (ii) Raw materials.
- (iii) Wages and salaries.
- (iv) Depreciation of machinery.
- (v) Power supplies expenses.

Which costs may be classified as variable costs of production?

- (a) (ii), (iii) and (v).
- (b) (i) and (iv).
- (c) (i), (iv) and (v).
- (d) (iii) and (iv).

(xv) If a customer deposits Shs.10,000/= on his account at a commercial bank and the cash ratio is 8%, what would be the total deposits created on the basis of it?

- (a) 8,000/=.
- (b) 10,000/=.
- (c) 125,000/=.
- (d) 80,000/=.

- (xvi) Which of the following is not an objective of commercial banks?
- (a) To maximise profits on behalf of shareholders.
 - (b) To control the supply of money in the economy.
 - (c) To maintain sufficient assets in liquid form to meet customers' withdrawal requirements.
 - (d) To ensure that all lending is secured.
- (xvii) On average, male employees are paid more than female employees. What could be the reason for this?
- (a) A higher percentage of female employees belong to trade unions.
 - (b) Females have a longer working life.
 - (c) There are fewer female employees.
 - (d) A higher percentage of females work in unskilled occupations.
- (xviii) Vertical integration means:-
- (a) A merger between firms engaged in different stages of the production process.
 - (b) A situation when firms engaged in producing the same kind of good/service are brought under unified control.
 - (c) The establishment of a cartel to maintain price levels.
 - (d) A combination of firms which produce goods/services which are not directly related to one another.
- (xix) Which of the following is not a form of protection in international trade?
- (a) Excise duties.
 - (b) Import duties.
 - (c) Import quotas.
 - (d) Subsidies to producers in industries facing competition from imports.
- (xx) An Industry consists of firms, which may be defined as:-
- (a) Units enjoying the economies of large scale production.
 - (b) Units enjoying the advantages of division of labour.
 - (c) Independently administered business units.
 - (d) Units based on the concept of limited liability.

SECTION B

Question 2:

- (a) Define the term “price discrimination” **(2 marks)**
 - (b) Explain four circumstances under which price discrimination works. **(8 marks)**
 - (c) With the aid of a diagram, show how a firm under monopoly determines output, price and profits in the short run. **(5 marks)**
- (Total 15 marks)**

Question 3:

- (a) Distinguish between standard of living and cost of living. **(4 marks)**
 - (b) Give five reasons why economic growth may not be accompanied by a corresponding rate of economic development. **(5 marks)**
 - (c) What are the benefits of economic growth in an economy? **(6 marks)**
- (Total 15 marks)**

Question 4:

- (a) Define:-
 - (i) Seasonal unemployment. **(2 marks)**
 - (ii) Disguised unemployment. **(2 marks)**
 - (b) Give five causes of unemployment in your country. **(5 marks)**
 - (c) Explain three policy measures to reduce unemployment in an economy. **(6 marks)**
- (Total 15 marks)**

Question 5:

(a) Define the following:-

- (i) Trade union. **(2 marks)**
- (ii) Collective bargaining. **(2 marks)**

(b) Give three functions of trade unions. **(3 marks)**

(c) What reasons are usually advanced by trade unions when demanding for higher wages? **(8 marks)**
(Total 15 marks)

Question 6:

(a) Study the table below showing the terms of trade for country X (1996-2000) and answer the questions that follow.

Year	Export Price Index	Import Price Index	Terms of Trade
1996	100	100	100
1997	142	108	-
1998	120	114	-
1999	128	132	-
2000	154	173	-

- (i) Calculate the terms of trade for years 1997-2000. **(4 marks)**
- (ii) Did country X experience favourable or unfavourable terms of trade in 1999?

Give reasons. **(2 marks)**

(b) When is a country is said to have:-

- (i) A balance of payments surplus? **(2 marks)**
- (ii) A balance of payments deficit? **(2 marks)**

(c) Explain five factors responsible for unfavourable balance of payments in less developed countries. **(5 marks)**
(Total 15 marks)

Question 7:

- (a) Distinguish between monetary policy and fiscal policy in your country. **(4 marks)**
- (b) Give three objectives of the monetary policy in your country. **(3 marks)**
- (c) Explain four factors limiting the effective operation of the monetary policy in your country. **(8 marks)**

Total 15 marks)