

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL ONE

ECONOMIC ENVIRONMENT – PAPER 2

MONDAY, 16 DECEMBER 2002

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 multiple-choice 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) Under which economic system are resources allocated on non-competitive basis?
- (a) Command economy.
 - (b) Mixed economy.
 - (c) Market economy.
 - (d) Traditional economy.
- (ii) Where an increase in price of a good has no effect on its quantity demanded, the good is said to be:
- (a) inferior.
 - (b) normal.
 - (c) necessity.
 - (d) giffen.
- (iii) What may cause the real income of the consumer to increase?
- (a) An increase in prices of goods and services.
 - (b) A fall in prices of goods and services.
 - (c) A decline in production.
 - (d) An increase in taxation.
- (iv) A firm maximizes profits when it produces a level of output at a point where:
- (a) total revenue = total cost.
 - (b) average revenue = average cost.
 - (c) marginal revenue = average revenue.
 - (d) marginal cost = marginal revenue.
- (v) Which of the following sources of finance is unlikely to be available to a small firm?
- (a) Borrowing from a bank.
 - (b) Selling shares to the general public.
 - (c) Re-investment of profits.
 - (d) Fundraising from friends.
- (vi) Which of the following is not a feature of oligopoly?
- (a) Price rigidity.
 - (b) Product homogeneity.
 - (c) Freedom of entry and exit.
 - (d) Product differentiation.

Study the table below showing the income of the consumer and the quantity demanded of commodity Q. Use the information to answer questions (vii) and (viii).

Income of the consumer in Shs.	Quantity demanded of Q in kgs
3,000	20
4,000	50

- (vii) Calculate the income elasticity of demand.
- 4.5
 - 4.5
 - 0.5
 - 0.5
- (viii) What is commodity Q?
- A normal good.
 - A substitute good.
 - A complimentary good.
 - An inferior good.
- (ix) Which approach is used to measure national income in Uganda?
- Income approach.
 - Expenditure approach.
 - Net national product approach.
 - Output approach.
- (x) The following may cause a balance of payment surplus except:
- an increase in prices of exports.
 - a fall in prices of exports.
 - a fall in prices of imports.
 - an improvement in quality of exports.
- (xi) In which way is economic growth different from economic development?
- Economic growth is qualitative in nature while economic development is not.
 - Economic development is concerned with increase in the volume of output while economic growth is both qualitative and quantitative.
 - Economic development is qualitative in nature while economic growth is not.
 - Economic growth is both quantitative and qualitative while economic development is not.

- (xii) Which of the following tools is most effective in closing a deflationary gap?
- (a) Purchase of government securities from the public.
 - (b) Upward adjustment in the bank rate.
 - (c) Downward adjustment in the minimum cash reserve ratio.
 - (d) Selective credit control.
- (xiii) Voluntary unemployment can be defined as a situation where people are:
- (a) willing to work at current wages but cannot find jobs.
 - (b) not willing to work at current wages.
 - (c) doing jobs they are not trained for.
 - (d) working but marginal productivity is zero.
- (xiv) A floating exchange rate is one where the price of one currency in terms of other currencies is:
- (a) fixed by the monetary authorities.
 - (b) determined by the value of the currency.
 - (c) allowed to fluctuate between two given margins determined by the central bank.
 - (d) determined by the market forces of demand and supply.
- (xv) Which of the following is an instrument of fiscal policy?
- (a) Changes in the level of government expenditure.
 - (b) Credit squeeze.
 - (c) Directly raising the level of money supply.
 - (d) Private investment finance to industry.
- (xvi) Which of the following is the best way of controlling demand pull inflation?
- (a) Expansionary monetary policy.
 - (b) Restrictive monetary policy.
 - (c) Expansionary fiscal policy.
 - (d) Increase in the level of exports.
- (xvii) The following are features of a customs union except:
- (a) Common external tariff.
 - (b) No barriers on goods and services between member states.
 - (c) Individual state external tariff.
 - (d) Joint policies on internal and external tariffs.

- (xviii) The export price index for country N in 2001 was 500 while the import price index was 400. Calculate the terms of trade for country N.
- (a) 1.25
 - (b) 0.8
 - (c) 80
 - (d) 125.
- (xix) Describe the terms of trade for country N in question (xviii) above.
- (a) Favourable terms of trade.
 - (b) Unfavourable terms of trade.
 - (c) Deteriorating terms of trade.
 - (d) Equilibrium terms of trade.
- (xx) A deliberate act by the government to reduce the value of its currency relative to other currencies is called:
- (a) deflation.
 - (b) devaluation.
 - (c) depreciation.
 - (d) floating.

SECTION B**Question 2**

- (a) (i) Distinguish between scarcity and choice. (2 marks)
 - (ii) Give any two decisions made by a firm. (2 marks)
 - (b) (i) What is meant by the term 'price mechanism'? (2 marks)
 - (ii) Give any five demerits of depending on the price mechanism to allocate resources. (5 marks)
 - (c) How can the defects of the price mechanism be minimized? (4 marks)
- (Total 15 marks)**

Question 3

- (a) (i) Define National Income. (2 marks)
 - (ii) Distinguish between Net Income from abroad and Net National Product. (4 marks)
 - (b) (i) Explain four causes of income inequalities in your country. (4 marks)
 - (ii) Give any five demerits of income inequalities. (5 marks)
- (Total 15 marks)**

Question 4.

- (a) Distinguish between:
 - (i) Average cost and marginal cost. (2 marks)
 - (ii) Average revenue and marginal revenue. (2 marks)
 - (iii) Distinguish between internal economies and external economies of scale. (2 marks)
 - (b) Why is the average cost curve of a firm U-shaped in the long run? (2 marks)
 - (c) (i) Differentiate between horizontal integration and vertical integration of firms. (2 marks)
 - (ii) Give any five advantages of integration of firms. (5 marks)
- (Total 15 marks)**

Question 5

- (a) (i) Distinguish between visible trade and invisible trade. (2 marks)
 - (ii) Give four reasons why the terms of trade of developing countries are deteriorating. (4 marks)
 - (b) (i) Distinguish between a fixed exchange rate and a managed exchange rate. (4 marks)
 - (ii) Give the merits of currency devaluation to an economy. (5 marks)
- (Total 15 marks)**

Question 6

- (a) Distinguish between:
 - (i) Public revenue and public expenditure. (2 marks)
 - (ii) Re-current expenditure and capital expenditure in a budget. (2 marks)
 - (b) Account for the persistent budget deficit in Uganda. (4 marks)
 - (c) (i) What is tax evasion? (2 marks)
 - (ii) Give five reasons why people evade paying taxes in your country. (5 marks)
- (Total 15 marks)**

Question 7

- (a) Define inflation. (1 mark)
 - (b) Distinguish between stagflation and imported inflation. (4 marks)
 - (c) Give any six negative effects of inflation on an economy. (6 marks)
 - (d) Explain any four policy instruments that have been used to control inflation in your country. (4 marks)
- (Total 15 marks)**