

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA(U) EXAMINATIONS

LEVEL ONE

ECONOMIC ENVIRONMENT – PAPER 2

TUESDAY, 11 DECEMBER 2007

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) Which of the following is **NOT** a feature of a free-enterprise economy?
- (a) Resources are privately owned.
 - (b) Prices are determined by demand and supply.
 - (c) Planning is done by a central authority.
 - (d) Freedom of choice and enterprise.
- (ii) Reserve price is that price:
- (a) at which a good is sold in the market.
 - (b) below which a good cannot be sold.
 - (c) fixed by a dominant firm.
 - (d) fixed by a manufacturer.
- (iii) A negative coefficient of cross elasticity of demand means that the goods:
- (a) are complementary.
 - (b) are substitutes.
 - (c) have inelastic demand.
 - (d) have elastic demand.
- (iv) Which of the following best describes a mixed economy?
- (a) Rural sector and urban sector.
 - (b) Agricultural sector and industrial sector.
 - (c) Small scale and large scale industries.
 - (d) Private sector and public sector.
- (v) A firm's short run average cost curve (SAC) is u-shaped because of:
- (a) economies and diseconomies of scale.
 - (b) decreasing returns of scale.
 - (c) increasing returns of scale.
 - (d) the law of diminishing returns.
- (vi) The national income of a closed economy is expressed as:
- (a) consumption + income + exports.
 - (b) investment + imports + savings.
 - (c) consumption + investment + government expenditure.
 - (d) government expenditure + taxes + investment.

- (vii) Economies of scale are advantages of:
- (a) large scale production.
 - (b) using better technology.
 - (c) better utilization of resources.
 - (d) economic stability in the market.
- (viii) Average revenue of a firm is:
- (a) revenue obtained after selling a commodity.
 - (b) revenue obtained per unit of output sold.
 - (c) additional revenue got after selling an extra unit of output.
 - (d) the difference between total cost and total revenue.
- (ix) Which of following policies is usually used by the government to reduce unemployment?
- (a) Wage policy.
 - (b) Price policy.
 - (c) Expansionary monetary policy.
 - (d) Restrictive monetary policy.
- (x) Which of the following is **NOT** a function of money?
- (a) Acceptability.
 - (b) Measure of value.
 - (c) Medium of exchange
 - (d) Standard for deferred payments.
- (xi) Given a cash ratio of 10% and an initial deposit of Shs 20 million, calculate the total deposits created.
- (a) Shs 200 million.
 - (b) Shs 180 million.
 - (c) Shs 100 million.
 - (d) Shs 50 million.
- (xii) Which of the following may cause cost-push inflation?
- (a) An increase in money supply.
 - (b) A rise in the rate of interest on borrowed funds.
 - (c) An increase in demand for consumer goods.
 - (d) A fall in the level of indirect taxes.

- (xiii) The main reason why government subsidises local firms is to:
- (a) become popular.
 - (b) control production.
 - (c) regulate investment.
 - (d) reduce costs of production.
- (xiv) Progressive taxation is used by the government to achieve the following **EXCEPT**:
- (a) reduce income inequalities.
 - (b) reduce monopoly power.
 - (c) encourage savings.
 - (d) reduce inflation.
- (xv) Given the exchange rate as US\$ 1 = Shs 1,800 and the shilling is devalued by 20%, what is the new exchange rate?
- (a) 1 US\$ = Shs 1,440.
 - (b) 1 US\$ = Shs 1,780
 - (c) 1 US\$ = Shs 1,820.
 - (d) 1 US\$ = Shs 2,160.
- (xvi) A situation of free trade and common external tariff is:
- (a) free trade area.
 - (b) customs union.
 - (c) common market.
 - (d) economic union.
- (xvii) The difference between the value of visible exports and visible imports of a country is called:
- (a) visible trade.
 - (b) terms of trade.
 - (c) balance of trade.
 - (d) balance of payments.
- (xviii) Commercial banks achieve the objective of liquidity through the following **EXCEPT**:
- (a) phased lending.
 - (b) high minimum balance.
 - (c) liquid assets.
 - (d) long term lending.

- (xix) A situation where labour works less hours than normal is described as
- (a) underemployment.
 - (b) unemployment.
 - (c) cyclical unemployment.
 - (d) frictional unemployment.
- (xx) is **NOT** a tool of fiscal policy.
- (a) taxation.
 - (b) interest rates.
 - (c) public debt.
 - (d) government expenditure.

SECTION B

Question 2

- (a) What is "a firm"? (1 mark)
- (b) Distinguish between breakeven point and shut down point of a firm. (4 marks)
- (c) Identify **five** reasons why a firm may continue operating even if it is incurring losses. (10 marks)
- (Total 15 marks)**

Question 3

- (a) Distinguish between perfect competition and monopolistic competition. (4 marks)
- (b) Give **four** features of monopolistic competition. (4 marks)
- (c) Illustrate how a monopolistic competitive firm maximizes profit in short run. (7 marks)
- (Total 15marks)**

Question 4

- (a) Define the term “economic growth”.
(2 marks)
 - (b) Outline **three** circumstances when economic growth may **NOT** be followed with economic development.
(3 marks)
 - (c) Explain **five** factors that determine the rate of economic growth in your country.
(10 marks)
- (Total 15marks)

Question 5

- (a) Define the term “exchange rate”.
(1 mark)
 - (b) Distinguish between a fixed exchange rate and a floating exchange rate.
(4 marks)
 - (c) Explain **five** criticisms of the law of comparative advantage.
(10 marks)
- (Total 15 marks)

Question 6

- (a) Distinguish between demand pull inflation and cost push inflation.
(4 marks)
 - (b) State **three** causes of demand pull inflation in your country.
(6 marks)
 - (c) Give **five** ways of controlling inflation in your country.
(5 marks)
- (Total 15 marks)

Question 7

- (a) Define the term “public finance”.
(2 marks)
 - (b) Outline **five** reasons why countries incur public debts.
(5 marks)
 - (c) Explain **four** methods used to reduce the burden of public debts in your country.
(8 marks)
- (Total 15 marks)