

CERTIFIED PUBLIC ACCOUNTANT

FOUNDATION LEVEL 2 EXAMINATIONS

F2.2: ECONOMICS AND THE BUSINESS ENVIRONMENT

WEDNESDAY: 3 DECEMBER 2014

INSTRUCTIONS:

- 1. Time Allowed: 3 hours 15 minutes** (15 minutes reading and 3 hours writing).
- 2. This examination has seven questions and only five questions are to be attempted.**
- 3. Marks allocated to each question are shown at the end of the question.**
- 4. Show all your workings**

QUESTION ONE

- a) New Century Cinema has just begun showing a new movie Ice Age 7. The market price for cinema tickets is Frw 300 and the number of tickets bought in the market per day is 100. Demand is known to be of the form $Q=a-5P$.
- i) Calculate the elasticity of demand at a price of 300. (4 Marks)
Giving reasons, explain if the demand is elastic or inelastic (2 Marks)
- b) Explain, with the help of clearly labeled diagrams, the effect on equilibrium price and quantity when
- (i.) Demand is elastic (3 Marks)
(ii.) supply is inelastic (3 Marks)
- c) Using examples from Rwanda, discuss **four** factors that can cause a shift in the demand curve. (8Marks)

Total 20 Marks

QUESTION TWO

“In pursuing the goal of medium-term to long term price stability, the National Bank of Rwanda agrees with the Government on the objective of keeping consumer price inflation low and stable. This formulation allows short-run variation in inflation while preserving a clearly identifiable performance benchmark over time”

- a) Discuss five tools that BNR can use to “...keep consumer price inflation low and stable. (10 Marks)
- b) Discuss the short-run and long-run effect of technological change on the labor market. (10 Marks)

Total 20 Marks

QUESTION THREE

- a) Define the term monopoly (2 Marks)
- b) Explain the factors that give rise to monopoly (8 Marks)
- c) Explain 6 assumptions for perfect competition market structure (6 Marks)
- d) Outline four characteristics of oligopoly (4 Marks)

Total 20 Marks

QUESTION FOUR

- a) Given an economy where consumption, taxes, investment and imports are induced or endogenous while transfer of payments, government expenditures and exports are autonomous; derive and explain the export and import Multiplier. (6 Marks)
- b) The Ministry of Finance in Rwanda has collected economic sector annual revenues in US Dollars at market prices for the financial year 2013 given as follows:

| | |
|--|---------|
| Consumption expenditure of households (<i>C</i>) | 655,265 |
| Government final consumption (<i>G</i>) | 190,663 |
| Gross capital formation (<i>I</i>) | 164,048 |
| Exports of goods and services (<i>X</i>) | 268,451 |
| Imports of goods and services (<i>M</i>) | 290,912 |
| Statistical discrepancy | 499 |
| Net income from abroad | 5,756 |
| Capital consumption (depreciation) | 111,275 |

Required:

Calculate the Net National Income (NNI), Gross domestic product (GDP) (at market prices) and Gross National Income (GNI). (4 Marks)

- c) Give four major reasons why it's important to estimate the National Income of a Country? (4 Marks)
- d) What difficulties do economists encounter while carrying out such a task particularly in developing countries? (6 Marks)

(Total: 20 Marks)

QUESTION FIVE

The table below shows the summary of the firm's production analysis. Use the information to answer the questions:

| Wheat production per year from a particular farm (tonnes) | | | |
|---|-----|-------------|---------------------------------|
| Number of workers (LB) | TPP | APP= TPP/LB | MPP=Change in TPP/ Change in LB |
| 0 | 0 | - | - |
| 1 | 3 | 3 | 3 |
| 2 | 10 | 5 | 7 |
| 3 | 24 | 8 | 14 |
| 4 | 36 | 9 | 12 |
| 5 | 40 | 8 | 4 |
| 6 | 42 | 7 | 2 |
| 7 | 42 | 6 | 0 |
| 8 | 40 | 5 | -2 |

Required:

- a) Outline the assumptions on which the table is based; (3 Marks)
- b) Using graphs demonstrate the relationship between TPP, APP & MPP and explain how the three curves behave alongside each other. (10 Marks)
- c) What are the economic reasons behind the law of diminishing returns? (3 Marks)
- d) Name and explain the characteristics of the three stages of production resulting from the law of diminishing returns. (4 Marks)

(Total: 20 Marks)

QUESTION SIX

Jean Claude Nyandwi is a small scale farmer who concentrates on growing maize. Last season, the price of maize was high, and he could have sold much more than he had grown, so this season he has planted twice as much maize as last season. However, as harvest approaches, Jean Claude is disappointed to find that maize prices have dropped in the local market, so he is already thinking of planting less in the next season.

- Identify at least **THREE** factors which could cause fluctuations in the prices of maize (6 Marks)
 - Which theory explains the connection between the price of maize and decisions of producers such as Jean Claude? (3 Marks)
 - What conditions are necessary for maize to return to equilibrium following a price increase of 50%. Illustrate your answer with a graph and explain the movements in production and consumption over the next growing periods. (6 Marks)
 - Which policies can be implemented by government to reduce the effect of price fluctuations experienced by farmers? (5 Marks)
- (Total: 20 Marks)**

QUESTION SEVEN

Study the table below showing the terms of trade for country X (2010 - 2014) and answer the questions that follow.

| Year | Export Price Index | Import price Index | Terms of Trade |
|------|--------------------|--------------------|----------------|
| 2010 | 100 | 100 | 100 |
| 2011 | 142 | 108 | - |
| 2012 | 120 | 114 | - |
| 2013 | 128 | 132 | - |
| 2014 | 154 | 173 | - |

- Calculate the terms of trade for years 2011 - 2014. (4 Marks)
 - Did country X experience favourable or unfavourable terms of trade in 2013? Give reasons. (5 Marks)
 - When is a country is said to have:
 - A balance of payments surplus? (3 Marks)
 - A balance of payments deficit? (3 Marks)
 - Explain five factors responsible for unfavourable balance of payments in less developed countries (5 Marks)
- (Total: 20 Marks)**

End of question paper