

EXAMINERS' COMMENTS

SUBJECT	SESSION
Introduction to Economics and Finance	Foundation Examination – Spring 2008

General:

The performance this time was relatively better. However, majority of the answer scripts depicted that the students had resorted to selective studies. The topics which are not frequently asked were not prepared well and as a result the performance in question 3, 6b and 7b was quite poor.

The question-wise comments are given below:

- Q.1 (a) Factors such as changes in the price of related goods, taste and fashion, income, future expectations and weather conditions etc. were correctly identified by the students as the main determinants of demand. But the proper explanation of these factors was often missing. In many cases hardly anything was written in the explanation; for example it was often said “when income changes, demand changes” without explaining how more income generates more demand.
- (b) In this part most of the students mentioned the features, advantages and disadvantages of mixed economy. Hardly anyone wrote about the role of state in a mixed economic system. Some of the students did write about the provision of merit goods and measures to control unemployment but there was a lot of repetition. Measures regarding price controls, restraining monopolies and controlling unequal distribution of wealth were rarely mentioned.
- Q.2 Quite a good number of candidates confused balance of payment with the current account of the balance of payment account. Majority of them correctly identified the measures to rectify the BOP deficit such as depreciation of the local currency, increase in import tariff, introduction of quotas, exchange controls and export subsidies. However, when it came to explanation of these factors the performance was again poor as mostly no explanation was offered except phrases like “increase in import tariff decreases imports”. Students should realize that when they have identified a certain factor then saying further that it is a factor which affects the BOP, adds no value to their answers.
- Q.3 In this question majority of the students performed badly because they did not try to understand the requirement of the question. They ended up explaining the social and political factors that may cause a change in the demand and supply of the loanable funds instead of correctly identifying savings, investment, consumption, hoarding of funds, liquidity with the banks etc. as the main determinants of demand and supply of loanable funds. Many students explained liquidity preference and gave diagrams showing how interest rate is determined, which was not required.

- Q.4 (a) Here again, the functions of money such as being a medium of exchange, standard of deferred payments, store of value etc. were correctly identified. However, in the explanations there was lot of confusion and repetition. This has been the case in other questions also. Some students got confused and explained the characteristics of money such as it is generally acceptable; it is divisible into smaller units etc., which were not required.
- (b) Most of the students identified and explained the three motives i.e. transaction motive, precautionary motive and speculative motive correctly. Some of the students explained the term "Liquidity", which was not required. Some of the students wrote vague and inconclusive comments such as "It has a very significant effect on the liquidity preference". Such comments are counter productive and a waste of time.
- (c) Most of the students were able to explain open market operations and the purpose of undertaking such operations. However, the following errors were also visible in many answers.
- It was stated that open market operation is a process of "buying and selling" without specifying as to what is bought or sold.
 - In some cases only selling of government securities was stated and there was no mention of purchasing and vice versa.
 - Many students stated that such operations are carried out to curtail inflation or to curtail excess supply of money without realizing that such operations may also be carried out to curb deflation or to increase the supply of money.
- Q.5 The performance of the students in this question requiring explanation of the concepts of Price Effect, Substitution Effect and Income Effect was satisfactory. However, some of the common mistakes made by many candidates were as follows:
- A large number of students were of the view that when the price of a certain product is reduced, only consumption of that product is increased. In fact when the price is reduced, the consumer has extra money to spend and usually he uses it to buy more of both products.
 - In the diagram for Substitution Effect, many students specified two equilibrium points but did not state as to which of them was before or after the change in prices. Some students acted rather casually and identified the equilibrium point before change in price as the point after change in price and vice versa.
- Q.6 (a) Most of the students performed well in this part of the question as they were able to explain the term "Land" correctly. The important characteristics which form the basis of determination of rent such as location, fertility, utility for a specific purpose etc. were also identified correctly.

- (b) Although majority of the students are familiar with the context in which the term “marginal” is used in Economics yet many of them got confused. Instead of explaining the concept of marginal efficiency of capital, they tried to explain the factors affecting the rate of interest.

However, almost half the students secured good marks by explaining the concept correctly i.e. with reference to the return on additional investment and the declining trend associated with such return.

- Q.7 (a) Most of the candidates were able to explain that demand for consumer goods is Direct Demand whereas demand for capital goods is termed as Derived Demand. Appropriate examples were also given and majority of the students secured high marks.
- (b) Very few of the students were able to explain that Net Interest represents the return paid to compensate for the use of funds. On the other hand, when other charges such as documentation charges, insurance charges, valuation costs etc. are added to Net Interest, it is termed as Gross Interest.

- Q.8 Most of the students wrote the correct definition but could not describe the conditions under which a firm can resort to Price Discrimination. Such conditions are said to prevail when different markets have different elasticities of demand, different tariffs, different types of customers, or are situated at different locations.

- Q.9 The performance of the students in this question was somewhat surprising. Whereas most of them seemed to have a good knowledge of the related diagram which was correctly produced in the answers, very few of them were able to offer appropriate explanations. Very few of them could identify the following conditions in their answers:

- A monopolist will keep on producing as long as Marginal Revenue (MR) is greater than Marginal Cost (MC).
- He will be in equilibrium when $MC = MR$ and when the MC curve cuts the MR Curve from below.
- The distance between Average Revenue (AR) Curve and Average Cost (AC) Curve represents the profit per unit.
- The average profit per unit multiplied by the output gives the total profit.

(THE END)