The Institute of Chartered Accountants of Pakistan

Introduction to Economics and Finance

Foundation Examination — 7 September 2011
Autumn 2011 — 100 marks – 3 hours
Module B — Additional reading time – 15 minutes

Instructions to candidates:

(i) All the Questions from Section A are compulsory.
(ii) Attempt any TWO out of THREE Questions from Section B.

Section A

Q.1 (a) What do you understand by the concept of "Consumer Sovereignty"? ***(02 marks)***
(b) Briefly describe the demerits of Free Market Economy. ***(07 marks)***

Q.2 (a) What is meant by "Competitive goods" and "Complementary goods"? Give two examples of each. (***04 marks)***
(b) Explain briefly the factors which determine the Price Elasticity of Demand. ***(06 marks)***
(c) Illustrate the relationship between the price and quantity demanded with the help of a diagram when the price elasticity of demand is Elastic, Unitary Elastic and Inelastic. ***(Explanation is not required)*** ***(06 marks)***

Q.3 (a) What is "Price Discrimination"? Identify and describe briefly the conditions under which a monopolist can keep the sub-markets separate for exercising price discrimination. ***(10 marks)***
(b) How a firm can improve its profits by using price discrimination? ***(Diagram is not required)*** ***(06 marks)***
(c) Briefly explain the concept of economies and diseconomies of scale. ***(04 marks)***

Q.4 Select appropriate answer from the options available for each of the following Multiple Choice Questions (MCQ). **Each MCQ carries <u>ONE</u> mark.**

(i) Following concept is **NOT** illustrated by the Production Possibility Curve:
(a) efficiency (b) opportunity cost (c) equity (d) trade-off

(ii) If the market price of a product increases from Rs. 35 to Rs. 40 and in response, the quantity demanded decreases from 1400 units to 1200 units, the value of its price elasticity of demand is:
(a) 0.9 (b) 1 (c) 1.1 (d) 1.2

(iii) The demand for a Factor of Production is called:
(a) quantity demand (b) derived demand (c) factor price (d) cost of production

(iv) If the nominal interest rate is 5% and the inflation rate is 2%, then the real interest rate is:
(a) 2% (b) 3% (c) 5% (d) 7%

(v) On a short-run Phillips Curve, high rates of inflation coincide with:
(a) low interest rates (b) high unemployment rates
(c) low unemployment rates (d) low discount rates

(vi) A stimulative fiscal policy combined with a restrictive monetary policy will necessarily cause:
(a) gross domestic product to increase (b) gross domestic product to decrease
(c) interest rate to fall (d) interest rates to rise

(vii) As its output increases, a firm's short-run marginal cost will eventually increase because of:
(a) diseconomies of scale
(b) a lower product price
(c) the firm's need to break even
(d) diminishing returns

(viii) Which of the following are regarded as withdrawals from the circular flow of income?
(a) saving and taxation
(b) export and import
(c) investment and saving
(d) Government spending and borrowing

(ix) Which of the following would reduce inflation?
(a) an increase in direct taxes
(b) an increase in indirect taxes
(c) increase in government spending
(d) increase in income

(x) Which of the following factor is not used in the multiplier formula for the open economy?
(a) marginal propensity to save
(b) marginal propensity to import
(c) marginal propensity to tax
(d) marginal propensity to export

(xi) When one country is more efficient in the production of a particular good as compared to another country, that country is said to have:
(a) economies of scale
(b) an oligopoly
(c) comparative advantage
(d) absolute advantage

(xii) All of the following are determinants of supply except:
(a) price
(b) income level
(c) level of technology
(d) objectives of the firms

(xiii) Which of the following would decrease aggregate demand?
(a) increased investment
(b) increase in export revenue
(c) increased taxation
(d) increased consumption

(xiv) Which of the following is regarded as an argument in favour of trade protection?
(a) to protect domestic labour against cheap foreign labour
(b) to reduce domestic unemployment
(c) to protect infant industries
(d) all of the above

(xv) To counteract a recession, the Central Bank should:
(a) raise the reserve requirement and the discount rate
(b) sell securities on the open market and lower the discount rate
(c) buy securities on the open market and raise the discount rate
(d) buy securities on the open market and lower the discount rate

Section B

Q.5 (a) Money has been defined by various economists on the basis of its elementary components. Define money using "Traditional Approach" and "Monetarist Approach". ***(04 marks)***
(b) Identify and explain briefly the different functions of money. ***(08 marks)***
(c) Describe the effects of inflation on the functions of money. ***(08 marks)***

Q.6 (a) What do you understand by the term National Income? ***(02 marks)***
(b) Explain briefly three different ways of measuring the National Income. ***(09 marks)***
(c) Enumerate the difficulties generally faced in measuring National Income. ***(09 marks)***

Q.7 (a) What is meant by the term "Trade Deficit"? Briefly describe the key measures a government may undertake to control the deficit on the country's balance of trade. ***(08 marks)***
(b) Explain briefly different classes of taxes with the help of a diagram. ***(06 marks)***
(c) Give any **one** advantage and disadvantage of each of the above class of taxes. ***(06 marks)***

(THE END)