



CERTIFIED PUBLIC ACCOUNTANT

FOUNDATION LEVEL 2 EXAMINATIONS

F2.2: ECONOMICS AND BUSINESS ENVIRONMENT

DATE: THURSDAY 27, APRIL 2023

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 should be attempted.**
- 3. Marks allocated to each question are shown at the end of the question.**
- 4. Show all your workings where necessary.**
- 5. The question paper should not be taken out of the examination room.**

QUESTION ONE

a) In ordinary market settings, it would be expected that a change in income is associated with a corresponding change in demand. However, for some goods or services, a change in income is rather associated with a reverse effect in demand.

Required:

- i) Identify and explain the type of good whose demand falls when income rises, and vice versa. (4 Marks)
- ii) How would you interpret the following equation as far as influence in demand in a market is concerned? $Q = f(P_o, P_a, Y_d, N, A, T)$. Where: P_o : Price of the product, P_a : Price of other product, Y_d : Disposable income, N : Market size, A : Market effort, T : Customer taste. (12 Marks)
- b) A price ceiling is the highest price a commodity can be sold at in a market. Some regulators set a maximum price to stop the price of products from rising to an unacceptable level in an attempt to protect low-income consumers.

Required:

Referring to the above statement, state four consequences of price ceilings. (4 Marks)

(Total: 20 Marks)

QUESTION TWO

There is no simple or generally agreed explanation of the economic function of profit, though most would agree that both profit and a spirit of enterprise are extremely important elements in modern market economies. Profit has been explained in different ways.

Required:

- a) Using Professor Samuelson's theory, explain six distinct views on profit. (12 Marks)
- b) Briefly explain who should own profit if it is not considered as a factor payment but rather as a surplus remaining after the usage of factors of production have been paid for. (4 Marks)
- c) Using a diagram, describe a consumer surplus. (4 Marks)

(Total: 20 Marks)

QUESTION THREE

There has always been debates that a profitable firm is that considered a “price maker” than a ‘price taker’. However, in every market there are driving forces of demand and supply that at times assume perfection in a market. Very limited set of requirements would be satisfied when firms in an industry were subject to a regulated price set by a government or some other regulatory body which had powers to buy goods un-saleable in the market. In any manner, all this might or might not create movement towards equilibrium in perfectly competitive markets.

Required:

- a) Using an appropriate a diagram, **explain the behavior of firms operating under conditions of perfect competition.** **Note:** Assume that the firm is experiencing diminishing marginal returns and can sell all it can produce at the market price, over which it has no control. Also assume unrestricted entry and exit of firms in the market. (10 Marks)
- b) **Discuss any five conditions that must exist for true perfect competition to happen.** (10 Marks)

(Total: 20 Marks)

QUESTION FOUR

There have always been disagreements between economists that large firms, mostly oligopolies, do not maximize profits. Several alternative theories of the firm have been developed and each of these is based on different assumptions about firms’ behavior.

Required:

- a) **Briefly explain alternative maximizing theories and satisficing theories of firms’ behaviour.** (6 Marks)
- b) **With help of a diagram, explain an economic rent in the market.** (8 Marks)
- c) **Explain the different degrees of price discrimination by suppliers.** (6 Marks)

(Total: 20 Marks)

QUESTION FIVE

a) The following table 1 describes the changes in the Gross National Product (GNP) versus the changes in inflation for Rwanda. It is argued that the real GNP can still increase irrespective of increases in inflation.

Year	2020	2021	2022
GNP (FRW million) (current market prices)	40,000	43,000	46,300
Price Index – Inflation	100	105	112
GNP (FRW million) (constant prices)	40,000	?	?

Required:

From the above table you are required to measure the following:

- The GNP figures for 2021 and 2022. (3 Marks)
 - The percentage changes realized in output from 2020 through to 2022. (2 Marks)
- b) An investment is committing resources to a long-term project with a view to earning a satisfactory return over the period of the project

Required:

Explain the six main factors that can influence the volume of investment. (12 Marks)

- c) There are various problems that need to be avoided if an accurate measure of Gross Domestic Product (GDP) is to be achieved.

Required:

State three problems associated with the estimation of National Income. (3 Marks)

(Total: 20 Marks)

QUESTION SIX

a) The modern banking sector has been operating on a principal of fractional reserve banking. However, every commercial bank will always focus on aspects that will realize much of profit making and that is why they ensure that every deposit from a client is multiplied into extra units. They visage more loans to clients from the fact that every bank is aware that not all depositors will be in a position to frequently withdraw their money. Therefore, every fraction of liabilities must be held in reserve for the bank to meet its daily operations. More or so, excessive reserves suggest that the bank should increase loans in pursuit of profit. Assume Northern Rock Bank operates with an RAR (Reserve Asset Ratio) of 20% with an increase of deposits of FRW 1 million.

Required:

- i) Using the above information, calculate the bank's deposit liabilities. (2 Marks)
- ii) Compute the increase in bank loans caused by the FRW 1 million cash deposit. (3 Marks)
- iii) What will be the credit multiplier? (2 Marks)
- b) Explain three ways of levying taxation (6 Marks)
- c) Explain three advantages and four disadvantages of indirect taxes. (7 Marks)

(Total: 20 Marks)

QUESTION SEVEN

The African Continental Free Trade Area is one of the 13 flagship projects of agenda 2063 of the African Union. Rwanda with other African countries have embraced this important initiative to promote intra-Africa trade particularly in value-added production so that their inhabitants can enjoy a higher standard of living. Very few (if any) countries attempt to supply all their own economic needs.

Required:

- a) With reference to the above phrase, briefly describe the comparative costs theory. (2 Marks)
- b) Explain the rationale of free trade to increase economic welfare. (10 Marks)
- c) Explain a free-floating exchange rate system. (2 Marks)
- d) State four arguments in favor of free-floating exchange rates. (6 Marks)

(Total: 20 Marks)

End of Question Paper

