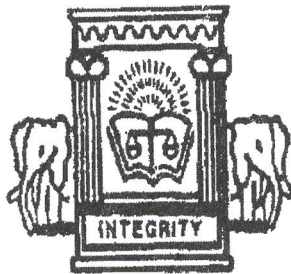# INSTITUTE OF CHARTERED ACCOUNTANTS (GHANA)

INTEGRITY

MAY 2011 EXAMINATIONS
(PROFESSIONAL)

PART 1

ECONOMICS
(Paper 1.3)

Attempt five (5) Questions

TIME ALLOWED:
Reading & Planning -   15 Minutes
Workings   -   3 Hours

SECTION A (MICROECONOMICS)

NB: Answer only three (3) Questions in this Section

QUESTION 1

a) State the basic law of demand. (*5 marks*)

b) Using the marginal utility approach, explain how a utility-maximising consumer consuming two normal goods X and Y will respond to a fall in the price of good X. (*15 marks*)

(**Total: 20 marks**)

QUESTION 2

The following were statements made by four candidates who were studying for ICA examination in Economics.

(a) Augustine – "An expected price increase of a good has the same effect as an increase in the current price of the good." (*5 marks*)

(b) Peter – "If the price of a good increases, the substitution effect measures the change in quantity demanded for that good which comes about because the good is now relatively expensive compared to its substitutes." (*5 marks*)

(c) Mensah – "If marginal cost is greater than average cost, then average cost must be falling." (*5 marks*)

(d) Kwesi – "A firm in a perfectly competitive industry faces a demand curve which is horizontal at the market price." (*5 marks*)

Required:

Ascertain whether these statements are **TRUE** or **FALSE** and explain your answer.

(**Total: 20 marks**)

QUESTION 3

(a)   Define
     (i)   Fixed Cost;   (*2 marks*)

     (ii)   Average Variable Cost;   (*2 marks*)

     (iii)   Marginal Cost Schedule.   (*2 marks*)

(b)   Karen Roses Limited has the following cost structure:

Output	Total Cost (TC) in cedis	Total Variable cost (TVC) in cedis	Average Veriable Cost (AVC) in cedis	Marginal Cost (MC) in cedis
0	800			
1	1000			
2	1400			
3	2100			
4	2800			
5	4000			
6	6000			

Required:

(i)   Copy and complete the Table by calculating, TVC, AVC and MC   (*9 marks*)

(ii)   What market structure is Karen Roses operating in?   (*1 mark*)

(c)   If the industry price is fixed at GHS1,200:

     (i)   Determine the profit maximizing level of output. Explain your answer.

                                                      (*2 marks*)

     (ii)   Calculate the maximum achievable profit.   (*2 marks*)

(**Total: 20 marks**)

QUESTION 4

a)   Define:

  (i)   Cross elasticity of demand.   (*2 marks*)

  (ii)   Income elasticity of demand.   (*2 marks*)

b)   Suppose the demand and supply functions are given by the following functions respectively. Price in cedis and quantity in kilos.

$$Q_d = 20 - 2P \qquad \text{(Demand function)}$$
$$Q_s = 10 + 3P \qquad \text{(Supply function)}$$

  (i)   Determine the equilibrium price and quantity.   (*4 marks*)

  (ii)   Calculate point price elasticity of demand at equilibrium.   (*3 marks*)

  (iii)   Compute point price elasticity of supply at equilibrium.   (*3 marks*)

c)   Explain any **two (2)** determinants of own price elasticity of demand.   (*6 marks*)

(Total: 20 marks)

NB: Answer only two (2) Questions in this Section

QUESTION 5

a) List **four (4)** reasons why countries calculate their national incomes.

(*4 marks*)

b) A hypothetical economy is described by the following set of equations

$$Y = C + I$$
$$C = 100m + 0.75Y$$
$$I = 80$$

Where Y = aggregate income

C = consumption expenditure

I = investment expenditure

M = millions of Ghana cedis

Required:

(i) Identify the type of economy represented in this model. (*1 mark*)

(ii) What is the value of the marginal propensity to consume in this economy? (*1 mark*)

(iii) What is the autonomous consumption? (*1 mark*)

(iv) Derive the complementary saving function for this economy. (*2 marks*)

(v) Calculate

1.	The equilibrium aggregate income	(*3 marks*)
2.	The equilibrium consumption expenditure	(*3 marks*)
3.	The multiplier for this economy	(*2 marks*)

(vi) Show that if this economy is in equilibrium, investment expenditure must equal saving.

(*3 marks*)

(**Total: 20 marks**)

QUESTION 6

a) Distinguish between

(i) Direct tax and indirect tax

(ii)   Equity and economy as used in taxation

(*8 marks*)

b)   Explain **four (4)** reasons why government of Ghana imposes taxes.

(*12 marks*)

(**Total 20 marks**)

QUESTION 7

a)   Define inflation.   (*2 marks*)

b)   The table below shows the consumer price indices (CPI) for 2007, 2008 and 2009 with 2000 as the base year.

Year	CPI	Rate of Inflation
2006	139	20%
2007	163	
2008	187	
2009	192	

(i)   Copy and complete the table by calculating the rate of inflation for 2007, 2008 and 2009.   (*6 marks*)

(ii)   What is the meaning of the changes in rates of inflation from 2007 to 2009?

(*3 marks*)

c)   What is a Phillips Curve?   (*3 marks*)

d)   With the aid of a short run Phillips curve, show that there is a trade off between inflation and unemployment.

(*6 marks*)

(**Total: 20 marks**)