

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD
A Committee of the Council of ICPAU

ECONOMIC ENVIRONMENT - PAPER 2

JUNE 1998

INSTRUCTIONS TO CANDIDATES

1. Time allowed: 3 hours
2. Attempt **all** questions in Section **A** and any **four** questions from Section **B**.
3. Section **A** has **twenty** compulsory questions each carrying 2 marks.
4. Section **B** has **six** questions and only **four** are to be attempted. Each question carries 15 marks.
5. Please read further instructions on the answer book.

SECTION A

Question 1

- (i) Which of the following is **not** considered a basic economic problem ?
- (a) Scarcity of economic resources.
 - (b) Choice as a result of insufficient resources.
 - (c) Opportunity cost involving a sacrifice of one commodity for another.
 - (d) Rising prices due to insufficient supply.
- (ii) In economic terms, a scarce good is one which is sold at
- (a) a price higher than the cost.
 - (b) a high price.
 - (c) a variable price.
 - (d) a price.
- (iii) Assuming the price of a commodity is constant, which statement could **not** explain an increase in the quantity demanded ?
- (a) an increase in consumer's income.
 - (b) a reduction in consumer's income.
 - (c) an increase in the price of a substitute.
 - (d) a reduction in the price of a complement.

The statement below applies to questions (iv) and (v).

In a commodity market, 60 kgs of commodity X and 50kgs of commodity Y are demanded when the price of Y is 500 Ush/kg. When the price of Y rises to 700 Ush/kg, 30kgs of X and 20 kgs of Y are demanded.

- (iv) What is the price elasticity of demand for commodity X ?
- (a) 1.3
 - (b) 1.5
 - (c) 2.9
 - (d) 4.0
- (v) What relationship exists between the commodities X and Y ?
- (a) Complementary relationship.
 - (b) Substitutional relationship.
 - (c) Zero relationship.
 - (d) Consolidated financial statements.

- (vi) If a government wants to maximise tax revenue, taxes should be levied on goods with
- (a) price inelastic demand.
 - (b) income inelastic demand.
 - (c) price elastic demand.
 - (d) price elastic supply.
- (vii) Which of the following factors is likely to result in a commodity having inelastic demand?
- (a) the commodity is a luxury item.
 - (b) there are few close substitutes for the product.
 - (c) there is little advertising of the product.
 - (d) the commodity accounts for a large proportion of consumer income.
- (viii) An inferior good is one which
- (a) is of inferior quality to similar products.
 - (b) is sold at a lower price than substitutes.
 - (c) consumers will demand less of as price falls.
 - (d) consumers will demand less of as income rises.
- (ix) Which of the following is **not** being used by the Ugandan government to control the rate of inflation?
- (a) increase in private investment.
 - (b) open market operations.
 - (c) restrictive fiscal policy.
 - (d) regulation of interest rates.
- (x) Which of the following explain the effect on the economy of the Central Bank raising interest rates?
- (1) An increase in investment expenditure.
 - (2) A reduction in the inflation rate.
 - (3) An increase in the savings rate.
- (a) 1 and 2.
 - (b) 2 and 3.
 - (c) All of the above.
 - (d) None of the above.

- (xi) Which of the following may occur when a country devalues its currency?
- (a) Imports will increase.
 - (b) Exports will increase.
 - (c) Terms of trade will improve.
 - (d) Interest rates will fall.
- (xii) Which of the following statements are correct if an exchange rate moves from \$1= 1,000 Ush to \$1= 1,200 Ush ?
- (1) The US \$ has appreciated against the Ugandan shilling.
 - (2) The Ugandan shilling has been devalued by 20%
 - (3) The Ugandan shilling is now stronger in value.
- (a) 1 only.
 - (b) 2 only.
 - (c) 1 and 2 only.
 - (d) All of them.
- (xiii) Which of the following can not explain the balance of payments problem of a developing country such as Uganda ?
- (a) a higher exchange rate.
 - (b) a lower exchange rate.
 - (c) an increase in import volume.
 - (d) a decline in export volume.
- (xiv) Which of the following statements **does not** apply to financing a balance of payments deficit ?
- (a) Borrowing from the Central Bank.
 - (b) Borrowing from the IMF.
 - (c) Raising taxes.
 - (d) Rescheduling debt repayments.
- (xv) Under which of the following circumstances are trade unions more likely to secure a higher wage differential for their membership ?
- (a) Where there is high unemployment.
 - (b) Where there is low unemployment.
 - (c) Where the demand for labour is relatively inelastic.
 - (d) Where the demand for labour is relatively elastic.

The statement below applies to questions (xvi) and (xvii).

The following amounts of income tax are payable at these levels of income (figures in Ush).

<u>Monthly Income</u>	<u>Tax Payable</u>
100,000	10,000
200,000	30,000
300,000	60,000

- (xvi) What are the rates of tax for these different income levels ?
- (a) 10%, 12% and 15%
 - (b) 10%, 12% and 20%
 - (c) 10%, 15% and 20%
 - (d) 10%, 20% and 30%
- (xvii) What form of taxation is this ?
- (a) proportional taxation.
 - (b) progressive taxation.
 - (c) regressive taxation.
 - (d) aggressive taxation.
- (xviii) Which of the following changes would require a reduction in the cost of investment to restore equilibrium in the economy ?
- (1) An increase in the inflationary gap.
 - (2) An increase in the deflationary gap.
 - (3) A recovery period in the trade cycle.
- (a) 1 only.
 - (b) 2 only.
 - (c) 3 only.
 - (d) 2 and 3 only.
- (xix) Which of the following statements best explains the phrase;
Terms of Trade.
- (a) The import purchasing power of exports.
 - (b) The export purchasing power of imports.
 - (c) The excess of the value of exports over the value of imports.
 - (d) The excess of the value of imports over the value of exports.
- (xx) At what stage of economic integration was the former East African Community (EAC) before its collapse ?
- (a) Preferential trade areas.
 - (b) Common market.
 - (c) Economic union.
 - (d) Customs union.

SECTION : B

Question 2

A businessman, Michael is planning to fly to Paris next week. A return ticket on the only airline which flies direct is \$850, yet if he had booked and confirmed his flight six weeks before departure the cost would have been \$700. However when he made the same trip last month, he paid \$ 1,000 for the ticket. A passenger next to Michael on same flight had bought a ticket at the last minute for \$650. He is angry about what he sees as unfair and confusing treatment, and wants to complain to the airline. Write a letter to Michael explaining how it is possible for the airline to charge different prices for the same ticket, including reasons why the price has been reduced since his first flight.

(15 marks)

Question 3

“A planned economy cannot be equated with socialism, capitalists also have plans. A market economy cannot be equated with capitalism, socialists also have markets. Both planning and the market are economic means.”

(Deng, a Chinese economist)

- (a) Outline **three** main features which distinguish a market economy from a planned economy. (5 marks)
- (b) Discuss the market economy as an alternative economic system. (10 marks)

Question 4

James Mukasa is a small 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. However, as harvest time approaches, James 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.

- (a) Identify at least **three** factors which could cause fluctuations in the price of maize. (3 marks)
- (b) Which theory explains the connection between the price of maize and the decisions of producers such as James? (1 marks)
- (c) What conditions are necessary for the maize market 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 four growing periods. (6 marks)
- (d) What policies can be implemented by government to reduce the effects of price fluctuations on farmers? (5 marks)

Question 5

- (a) What do the terms; **inflationary** and **deflationary gaps** mean? (6 marks)
- (b) Explain the possible measures which could be used in Uganda today to remove **inflationary gaps**. (9 marks)

Question 6

“In general, trade is controlled because governments think and act nationally than internationally.”
(J Harvey, Modern Economics)

- (a) What reasons are advanced by governments to justify such control of international trade? (6 marks)
- (b) Describe at least **four** methods which governments could use to control international trade. (9 marks)

Question 7

- (a) Briefly outline three types of financial markets. (5 marks)
- (b) What is the structure of financial markets in Uganda. (5 marks)
- (c) What challenges does Uganda face in setting up capital markets? (5 marks)