

**THE INSTITUTE OF CHARTERED
ACCOUNTANTS (GHANA)**



NOVEMBER 2006 EXAMINATIONS
(PROFESSIONAL)

PART 1

**ECONOMICS
(Paper 1.3)**

Attempt five (5) Questions

TIME ALLOWED: 3 HOURS

RUBRIC INSTRUCTIONS

Read the following instructions carefully before attempting the questions.

This paper is in **two (2)** Parts namely:

1] **SECTION A**

This section has four (4) questions out of which candidates are required to attempt only **THREE (3)**.

2] **SECTION B**

This section has three (3) questions out of which candidates are required to attempt only **Two (2)**.

SECTION A

NB: Answer only 3 questions in this Section

QUESTION 1

Suppose you are the Chief Executive of Karen Manufacturing Limited which produces a branded product called A4. You observed that you are meeting your company's sales target for 2006 accounting year. In view of this you are considering reducing the price of A4.

Suppose again that you call a meeting with your departmental heads to discuss the plan with them. At the meeting your sales manager informs members present that the own price elasticity for A4 is 0.5. The sales manager argues that the price cut will not achieve the desired result.

Required:

- i. Define own price elasticity of demand. **(2 Marks)**
- ii. Identify and explain two (2) factors that influence own price elasticity of demand. **(6 Marks)**
- iii. With the aid of diagram(s) show why you would agree or disagree with the sales manager. **(12 Marks)**

(Total: 20 Marks)

QUESTION 2

- a. What is meant by price discrimination?
- b. Explain three (3) pre conditions for successfully practising price discrimination.
- c. State and explain the equilibrium position of a discriminating firm operating in two markets.

(Total: 20 Marks)

QUESTION 3

- (a) Distinguish between technical efficiency and economic efficiency. **(4 Marks)**
- (b) The table below shows the production possibilities schedule of a hypothetical economy. Study the table carefully and answer the questions that follow.

Production Alternative	Food (tons)	Machines (units)
A	140	0
B	130	10
C	110	20
D	90	30
E	70	40
F	40	50
G	0	60

- i. What is the opportunity cost of producing
- a. 10 machines
 - b. 30 machines
 - c. 110 tons of food
 - d. 140 tons of food?
- (6 marks)**
- ii. Using graph Sheet, draw the Production Possibility Curve or factors. **(5 marks)**
- iii. What does the concave shape of the Production Possibility Curve illustrate? **(1 Mark)**
- iv. Explain any two (2) factors that can shift the Production Possibility Curve outwards. **(4 Marks)**

(Total: 20 Marks)

QUESTION 4

- a. Explain the following as used under the theory of consumer behaviour:
- i. Substitution Effect
 - ii. Income Effect
- (6 Marks)**
- b. With reference to the substitution effect and income effect, explain why a consumer buys more of a normal good as its price falls. Illustrate your answer with a diagram(s).

(14 marks)

(Total: 20 Marks)

SECTION B

QUESTION 5

In a hypothetical economy the Aggregate Expenditure/Demand (AE) is given as:

$$AE = C + I + G + (X - M)$$

and Aggregate Real Income (Y) is given as:

$$Y = C + S + T$$

Where C = Consumption Expenditure, I = Investment spending, G = Government Expenditure, X = Export, M = Import Expenditure, Y = Real Output/Income, S = Savings and T = Tax Revenue.

Required:

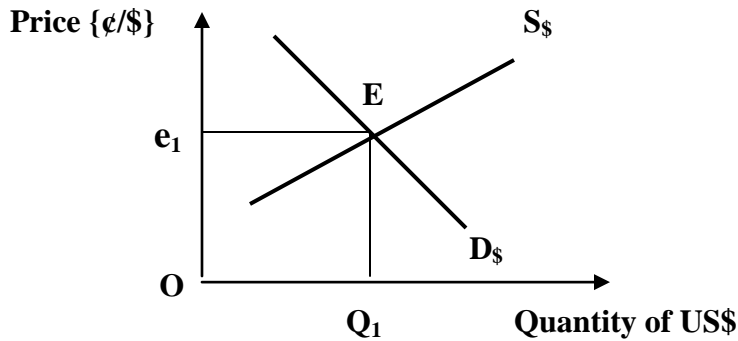
- a. Define Aggregate Expenditure (AE). ***(2 Marks)***
- b. Explain the meaning of “C” as a component of AE. ***(3 marks)***
- c. Define “I” and list its components. ***(5 Marks)***
- d. List the injections in this economy. ***(3 Marks)***
- e. Identify the leakages/withdrawals in this economy. ***(3 Marks)***
- f. Show that if this economy is in equilibrium, injections must equal leakages. ***(4 Marks)***

(Total: 20 Marks)

QUESTION 6

- a. What is meant by “foreign exchange market”? ***(4 Marks)***
- b. Explain the meaning of the following terms:
 - i. appreciation of a currency. ***(2 Marks)***
 - ii. depreciation of a currency. ***(2 marks)***

- c. The diagram below depicts the hypothetical market for US dollar by the Ghanaian economy for November 2006 in freely floating exchange rate regime:



Required:

Analyze the effects of the following events on the market for US dollars in Ghana in the month of November. In each case redraw the diagram and indicate and explain the effect of the event. State whether the cedi has depreciated or appreciated.

- i. An increase in the US dollar price of crude oil on the international market. **(4 Marks)**
- ii. A decrease in foreign purchases of cocoa. **(4 Marks)**
- iii. An increase in remittances to relatives in Ghana by Ghanaians abroad. **(4 Marks)**

(Total: 20 Marks)

QUESTION 7

- a) Explain the effect of an increase in a country's real gross domestic product on its total demand for money. **(4 Marks)**
- b) What is meant by supply of money? **(4 Marks)**
- c) Identify and explain three ways by which a central bank can influence the supply of money in an economy. **(12 Marks)**

(Total: 20 Marks)