

The Institute of Chartered Accountants [Ghana]



**MAY 2005
EXAMINATIONS**

Part 1

**ECONOMICS
(Paper 1.3)**

Attempt 5 questions in all

Time Allowed: 3 Hrs.

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

A survey conducted by the producers of imeal milk which operates in a competitive market showed the demand and supply schedules for the milk in Ghana as:

Price (¢)	Quantity demanded (million tins)	Quantity supplied (million tins)
6,000	5	8
5,000	6	7
4,000	7	6
3,000	8	5
2,000	9	4
1,000	10	3

Required:

- i. Plot the demand and supply curves and find the equilibrium price and quantity. **(Use graph sheet).** (5 marks)
- ii. Calculate the excess supply or demand when the price of imeal milk is:
(a) ¢6,000 (b) ¢2,000 (4 marks)
- iii. Explain how the price of imeal milk will change in situations (a) and (b) in (ii) above. (4 marks)
- iv. Suppose the quantity supplied at each price of imeal milk rises by one million tins:
 - a. What will be the new supply schedule? (2 marks)
 - b. By plotting the new supply schedule in the graph drawn to answer (i) above, determine the new equilibrium price and quantity. (3 marks)
- v. What will happen instead, if the price of bread rises? (2 marks)

QUESTION 2

- a. Define price elasticity of demand. (2 marks)
- b. Suppose you were the senior economist of the Mass Metro Transport Company of Ghana and you have estimated the demand function for bus riders in Accra to be:

$$R = 500,000 - 50P \text{ (all other things being equal)}$$

Where R is the number of riders per working day, and P is the bus fare.

Required:

- i. Calculate the number of riders per working day if the current bus fare is $\text{¢}1,500$. (4 marks)
- ii. Determine the total revenue if the bus fare is $\text{¢}1,500$ (2 marks)
- iii. Suppose price is increased from $\text{¢}1,500$ to $\text{¢}2,000$. Calculate the price elasticity of demand for bus riders in Accra. (6 marks)
- iv. Calculate the change in total revenue for this price increase. (3 marks)
- v. Account for the change in total revenue in (iv) above. (3 marks)

QUESTION 3

- a. Distinguish between fixed costs and variable costs. (4 marks)
- b. Opanyin Yaw Opoku, who owns a one hectare maize farm at Ejura has observed that as he varies the number of farm hands, his maize output varies per farming season.

His fixed costs – land, rent, capital charges, etc. – amount to $\text{¢}2$ million per farming season and for every one person he hires for a farming season he pays wages of $\text{¢}500,000$.

He has the following production and cost schedule:

Labour (No. of People)	Output (Bags of maize per farming season)	TFC (£)	TVC (£)	TC (£)	ATC (£)	MC (£)
1	3					
2	8					
3	14					
4	20					
5	25					
6	28					
7	30					

Where TFC = Total Fixed Cost
 TVC = Total Variable Cost
 TC = Total Cost
 ATC = Average Total Cost
 MC = Marginal Cost.

Required:

Complete the Production/Costs schedule. (10 marks)

- c. Explain the economic principle underlying the behaviour of the marginal cost values you have calculated. (6 marks)

QUESTION 4

- a. Briefly explain with a diagram, minimum price control. (8 marks)
- b. Explain two(2) reasons why governments set the minimum price. (4 marks)

- c. Outline any two(2) problems that may result from the setting of a minimum price. (4 marks)
- d. Suggest two(2) remedies to the problems that may result from the setting of a minimum price. (4 marks)

SECTION B

NB: Answer only 2 questions from this Section

QUESTION 5

- a. Distinguish between budget surplus, budget deficit. (4 marks)
- b. Explain four(4) sources of financing government budget deficit. (16 marks)

QUESTION 6

Suppose an open economy is represented by the following equations:

C	=	200 + 0.7 Y ^d	[Consumption function]
T	=	40 + 0.2 Y	[Tax function]
I	=	800	[Investment expenditure]
G	=	500	[Government expenditure]
X	=	200	[Export value]
M	=	150 + 0.3 Y	[Import function]

Required:

- i. What does the coefficient, 0.3 in the import function mean? (2 marks)
- ii. Derive the aggregate demand/expenditure function. (6 marks)
- iii. Compute the equilibrium income. (3 marks)
- iv. What is the equilibrium tax revenue? (3 marks)
- v. Determine the state of government budget and explain your answer. (3 marks)
- vi. Calculate the foreign trade balance. Explain your answer. (3 marks)

QUESTION 7

- a. With the aid of diagrams, explain:
- i. Demand-pull inflation. (6 marks)
 - ii. Cost-push inflation (6 marks)
- b. Suggest two(2) measures each to cure:
- i. Demand-pull inflation. (4 marks)
 - ii. Cost-push inflation. (4 marks)