# CERTIFIED ACCOUNTING TECHNICIAN

# LEVEL 1 EXAMINATION

# L1.5: ECONOMICS AND THE BUSINESS ENVIRONMENT

# MONDAY: 1 DECEMBER 2014

# 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 are to be attempted.

3. Marks allocated to each question are shown at the end of the question.

4. Show all your workings

# QUESTION ONE

a) 'If markets are left alone, price and quantity will always move to equilibrium'. Why then do governments choose to intervene? **(6 Marks)**

b) List and explain **three** kinds of Indirect taxes administered by Rwanda Revenue Authority. **(6 Marks)**

c) The cabinet has proposed an increase of VAT to 20% in order to maximize tax revenue and has requested the Minister for Finance to effect the changes. However the Minister is concerned about how this decision will affect the macroeconomic situation including the price level.

**Required:**

By use of a clearly labeled diagram, show the effect of such a policy decision on the

Rwandan Economy. **(8 Marks)**

**(Total 20 Marks)**

# QUESTION TWO

a) Define a production possibilities frontier (curve) and explain the difference between a bowed out PPC and a straight line PPC . **(6 Marks)**

b) MTD Contraco has been given two contracts by the Government of Rwanda which is road repairs and constructing extra classes in public schools. The operations manager is expected to prioritize the two activities and determine how much road repair work to do and how many classes to construct. In the last evaluation meeting, the Minister for Education was concerned that too few classes were built in the 2013-2014 financial year. The economic officer in MTD Contraco has provided a solution by showing the trade-off between the initiatives as shown in the table below:

| Alternatives | Schools | Road Repairs |
|---|---|---|
| A | 0 | 50 |
| B | 1 | 48 |
| C | 2 | 45 |
| D | 3 | 40 |
| E | 4 | 33 |
| F | 5 | 23 |
| G | 6 | 9 |
| H | 7 | 0 |

i) Calculate the opportunity cost of constructing extra classes for each alternative. **(6 Marks)**

ii) Draw a well labeled Production Possibility Curve for MTD Contraco and demonstrate what a point on, inside and outside of the curve represents . **(8Marks)**

**( Total 20 Marks)**

## QUESTION THREE

a) A nation with a big national income is a rich nation. What are the factors that influence the size of a national income? **(10 Marks)**

b) From the data below calculate the gross national product at factor cost:

| | Frw Million |
|---|---|
| Imports | 42,000 |
| Value of physical increase in stock | 1,300 |
| Exports | 43,000 |
| Capital formation | 25,000 |
| Government expenditure | 29,000 |
| Consumer expenditure | 84,000 |
| Taxes on expenditure | 20,000 |
| Subsidies | 3,000 |
| Net property income from abroad | 400 |

**(10 Marks)**

**(Total 20 Marks)**

## QUESTION FOUR

a) Define the concept "terms of trade" and differentiate between "Commodity or net barter" and "Income terms of trade". **(4 Marks)**

b) Examine the causes of  balance of payment problem in LDCs and suggest  the solutions to these causes **(10 Marks)**

c) Free trade between countries can be achieved if there is complete economic integration. Discuss the structures/forms or stages of economic integration . **(6 Marks)**

**( Total 20 Marks)**

## QUESTION FIVE

a) Illustrate and clearly explain the nature of indifference curves for perfect substitutes and for complementary goods **(7 Marks)**

b) Explain the property of convexity to the origin of an indifference curve. **(6 Marks)**

c) Using the cardinalist approach of consumer behavior, differentiate between income and substitution effects of a price rise for a normal good. **(7 Marks)**

**(Total: 20 Marks)**

## QUESTION SIX

a) Define the term multiplier. **(2 Marks)**

b) If investment increases by Frw 500,000 and MPC = 0.25, by how much does national income increase. **(6 Marks)**

c) Explain the term accelerator principle; given that consumption in maize increases from 20 Kg to 70 Kg and leads to increase in investment from Frw 100 to Frw 200 and the price of maize is Frw 1 per Kg determine the accelerator. **(3 Marks)**

d) Explain five limitations of accelerator principle. **(5 Marks)**

e) Distinguish between inflationary gap and deflationary gap. **(4 Marks)**

**(Total: 20 Marks)**

## QUESTION SEVEN

a) Explain the term `demand curve'. **(4 Marks)**

b) Identify two reasons why demand curve slopes downwards. **(6 Marks)**

c) Analyze the importance of elasticity of demand in economic decision making. **(10 Marks)**

**(Total: 20 Marks)**

# End of question paper