The Institute of Chartered Accountants of Pakistan

## Certificate in Accounting and Finance Stage Examinations

4 March 2015
3 hours – 100 marks
Additional reading time – 15 minutes

# Introduction to Economics and Finance

**Instructions to candidates:**

(i) ***All the Questions from Section A are compulsory.***
(ii) ***Attempt any FIVE out of SEVEN Questions from Section B.***

## Section A

Q.1 (a) What do you understand by the term "Production Possibility Curve" (PPC)? Why is PPC downward sloping and concave to the origin? **(04)**

(b) Under what conditions would PPC shift outwards? **(03)**

Q.2 (a) Illustrate with the help of a diagram, how new equilibrium market price of a good is achieved when price of substitute good increases. **(06)**

(b) List any **four** factors which are responsible for each of the following:
- Change in demand **(02)**
- Change in supply **(02)**

Q.3 (a) What do you understand by "economies of scale"? Briefly discuss any **four** factors that contribute towards achievement of economies of scale. **(07)**

(b) Explain economies and diseconomies of scale with the help of long run average cost curve. **(04)**

Q.4 (a) Explain the term equilibrium of the firm. **(02)**

(b) Briefly describe the reasons on account of which a firm under perfect competition acts as a 'price taker' rather than a 'price maker'. **(05)**

Q.5 Select the most appropriate answer from the options available for each of the following Multiple Choice Questions (MCQs). **Each MCQ carries ONE mark**.

(i) Which of the following is a basic economic problem?
(a) Lower incomes and higher taxes
(b) Unemployment and inflation
(c) Unlimited wants and scarce resources
(d) Balance of payment deficits and recession

(ii) Which of the following is more likely to be found in a free market economy than in a planned economy?
(a) An even distribution of wealth
(b) An incentive to innovate
(c) Production of goods for benefit of society as a whole
(d) Full employment of labour

(iii) A firm with existing sales of 1,000,000 units per annum is planning to increase the price of a product from Rs. 100 to Rs. 120 per unit. If price elasticity of demand for that product is 1.25, assuming no other changes, the sale of the firm after price increase would be:
(a) 1,250,000 units
(b) 750,000 units
(c) 1,200,000 units
(d) 800,000 units

(iv) If the government sets the maximum price of a product below the market equilibrium price, it would lead to:
(a) excess demand
(b) excess supply
(c) market equilibrium
(d) economies of scale

(v) Which of the following is **not** a characteristic of Indifference Curve (IC)?
(a) IC is negatively sloped
(b) Higher IC curve signifies higher level of utility
(c) IC is concave to the origin
(d) ICs cannot intersect each other

(vi) If marginal revenue is Rs. 50 and marginal cost is Rs. 40, the firm seeking profit maximization would:
(a) increase price
(b) reduce output
(c) reduce price
(d) increase output

(vii) Which of the following is a tool of expansionary policy?
(a) Increase taxes
(b) Reduce subsidies
(c) Allow tax rebates
(d) Freeze wages

(viii) While pursuing contractionary monetary policy, the government would:
(a) raise interest rates and sell securities
(b) lower interest rates and sell securities
(c) raise interest rates and buy securities
(d) lower interest rates and buy securities

(ix) In a given economy, out of every additional Rs. 1,000 of national income, Rs. 200 is taken in taxes, Rs. 100 is spent on imports and Rs. 500 is spent on domestically produced goods. The multiplier is:
(a) 1.25
(b) 2
(c) 2.5
(d) 1.67

(x) Sales tax on food items is an example of:
(a) direct tax
(b) fixed tax
(c) progressive tax
(d) regressive tax

(xi) Net National Product (NNP) can be arrived at from Gross National Product (GNP) by:
- (a) deducting depreciation
- (b) adding indirect taxes
- (c) deducting indirect taxes and adding depreciation
- (d) adding depreciation

(xii) Long Run Aggregate Supply (LRAS) curve is a vertical line because it is:
- (a) dependent on price level and signifies the upper limit of the capacity in the economy
- (b) dependent on price level and signifies the lower limit of the capacity in the economy
- (c) independent of price level and signifies the upper limit of the capacity in the economy
- (d) independent of price level and signifies the lower limit of the capacity in the economy

(xiii) Which of the following is a monetary measure for correcting the current account deficit?
- (a) Quotas
- (b) Export promotion
- (c) Import substitution
- (d) Exchange rate depreciation

(xiv) The gilt edged market is regarded as the market for:
- (a) stocks and shares
- (b) derivatives
- (c) high rated debt securities
- (d) all of the above

(xv) The main difference between an investment bank and a commercial bank is that investment bank:
- (a) does not accept deposits
- (b) does not underwrite shares
- (c) does not assist companies in acquiring funds
- (d) none of the above

## Section B

Q.6 (a) Briefly describe **three** different approaches to measure National Income. **(06)**

(b) Differentiate between "Autonomous" and "Induced" investments. Give any **two** examples of each. **(04)**

Q.7 (a) Discuss the Keynes' Psychological Law of Consumption and the related propositions. **(04)**

(b) Briefly describe the determinants of consumption in an economy. **(06)**

Q.8 (a) Briefly explain the 'Quantity Theory of Money'. **(03)**

(b) Identify **three** reasons why people prefer to hold money in liquid form. **(03)**

(c) Discuss how introduction of money has resulted in overcoming the shortcomings of barter system. **(04)**

Q.9 (a) Distinguish between 'Money Market' and 'Capital Market'. Identify any three institutions which operate in each market. **(06)**

(b) Identify any two capital market instruments that are available to the government for financing its expenditure. What factors the government should consider before raising finances through these instruments? **(04)**

Q.10 (a) State the meaning of 'Financial Intermediary'. **(02)**

(b) Describe the measures that are available to a central bank for restricting credit creation ability of commercial banks. How such measures affect the process of credit creation? **(08)**

Q.11 (a) What do you understand by the term 'Derivative'? List different ways in which derivatives are traded. **(03)**

(b) Explain the following financial instruments:
(i) Call and Put Options **(04)**
(ii) Swaps **(03)**

Q.12 (a) Illustrate with the help of a diagram, the concept of deflationary gap in the economy. **(04)**

(b) Various sources of short-term and long-term credit are available to the firms. Briefly discuss any **two** sources in each case. **(06)**

**(THE END)**