KASNEB REVISION KIT

ECONOMICS REVISION KIT

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UPDATED WITH MAY 2021 PAST PAPER

CPA

ECONOMICS

PART 1

CPA SECTION 2

REVISION KIT

INTRODUCTION

Following our continued effort to provide quality study and revision materials at an affordable price for the private students who study on their own, full time and part time students, we partnered with other team of professionals to make this possible.

This Revision kit (Questions and Answers) contains kasneb past examination past papers and their suggested answers as provided by a team of lecturers who are experts in their area of training. The book is intended to help the learner do enough practice on how to handle exam questions and this makes it easy to pass kasneb exams.

Special appreciation and recognition to the lecturers who have helped in the development of our materials, These are: FA Kegicha William Momanyi (MBA Accounting, CPA, CISA and CCP), Johnmark Mwangi (MSc Finance, CPAK, BCom Finance), FA Bramwel Omogo (B.sc Acturial Science, CIFA, CIIA final level and ICIFA member),CPA Gregory Mailu (Bsc. Economics) CPA Dominic Rasungu and CPA Lawrence Ambunya among others.

ECONOMICS

GENERAL OBJECTIVE

This paper is intended to equip the candidate with knowledge, skills and attitudes that will enable him/her to apply the fundamental principles of economics in decision making.

LEARNING OUTCOMES

A candidate who passes this paper should be able to:

- Apply basic mathematical and graphical techniques to analyse economic relationships and interpret the results
- Apply the knowledge of economics in decision making
- Analyse economic problems and suggest possible policy related recommendations
- Apply knowledge of economics in international trade and finance
- Apply economic principles in the development and implementation of policies in agriculture and industry

CONTENT

MICROECONOMICS

1. Introduction to economics

- Definition of economics
- Basic economic concepts: economic resources, human wants, scarcity and choice, opportunity cost, production possibility curves/frontiers
- Scope of economics: Micro and macro economics
- Methodology of economics: positive and normative economics, scientific methods, economics as a social science.
- Economic systems: free market economy, mixed economy, consumers' sovereignty.

2. Demand, supply and determination of equilibrium

Demand analysis

- Definition
- Individual demand versus market demand
- Factors influencing demand
- Exceptional demand curves
- Types of demand
- Movement along and shifts of demand curves
- Elasticity of demand
- Types of elasticity: price, income and cross elasticity
- Measurement of elasticity; point and arc elasticity
- Factors influencing elasticity of demand

- Application of elasticity of demand in management and economic policy decision making

Supply analysis
- Definition
- Individual versus market supply
- Factors influencing supply
- Movements along and shifts of supply curves
- Definition of elasticity of supply
- Price elasticity of supply
- Factors influencing elasticity of supply
- Application of elasticity of supply in management and economic policy decision making

Determination of equilibrium
- Interaction of supply and demand, equilibrium price and quantity
- Mathematical approach to equilibrium analysis
- Stable versus unstable equilibrium
- Effects of shifts in demand and supply on market equilibrium
- Price controls
- Reasons for price fluctuations in agriculture

3. The theory of consumer behaviour
- Approaches to the theory of the consumer - cardinal versus ordinal approach
- Utility analysis, marginal utility (MU), law of diminishing marginal utility (DMU)
- Limitations of cardinal approach
- Indifference curve analysis; Indifference curve and budget line
- Consumer equilibrium; effects of changes in prices and incomes on consumer equilibrium
- Derivation of a demand curve
- Applications of indifference curve analysis: substitution effect and income effect for a normal good, inferior good and a giffen good; derivation of the Engels curve
- Consumer surplus /Marshallian surplus

4. The theory of a firm

The theory of production
- Factors of production
- Mobility of factors of production
- Short run analysis
- Total product, average and marginal products
- Stages in production and the law of variable proportions/the law of diminishing returns

- Long run analysis
- Isoquant and isocost lines
- The concept of producer equilibrium and firm's expansion curve
- Law of returns to scale
- Demand and supply of factors of production
- Wage determination theories
- Trade unions: functions and challenges
- Producer surplus/economic rent/Marshallian surplus

The theory of costs

- Short run costs analysis and size of the firm's total cost, fixed cost, average cost, variable costs and marginal cost
- Long run costs analysis
- Optimal size of a firm
- Economies and diseconomies of scale

5 Market structures

- Definition of a market
- Necessary and sufficient conditions for profit maximisation
- Mathematical approach to profit maximisation
- Output, prices and efficiency of: perfect competition, monopoly, monopolistic competition, oligopolistic competition

MACROECONOMICS

6. National income

- Definition of national income
- Circular flow of income
- Methods/approaches to measuring national income
- Concepts of national income: gross domestic product (GDP), gross national product (GNP) and net national product (NNP), net national income (NNI) at market price and factor cost, disposable income
- Difficulties in measuring national income
- Uses of income statistics
- Analysis of consumption, saving and investment and their interaction in a simple economic model
- Determination of equilibrium national income
- Inflationary and deflationary gaps
- The multiplier and accelerator concepts
- Business cycles/cyclical fluctuations

7. Economic growth, economic development and economic planning

- The differences between economic growth and economic development
- Actual and potential growth
- The benefits and costs of economic growth
- Determinants of economic development
- Common characteristics of developing countries
- Role of agriculture and industry in economic development
- Obstacles to economic development
- The need for development planning
- Short term, medium term and long term planning tools
- Challenges to economic planning in developing countries

8. Money and banking

Money

- The nature and functions of money
- Demand and supply of money
- Theories of demand for money: The quantity theory, the Keynesian liquidity preference theory

The banking system

- Definition of commercial banks
- The role of commercial banks and non-banking financial institutions in the economy
- Credit creation
- Definition of central bank
- The role of the central bank; traditional and changing role in a liberalised economy, such as financial sector reform, exchange rate reform
- Monetary policy, definition, objectives, instruments and limitations
- Determination of interest rates and their effects on the level of investment, output, inflation and employment
- Harmonisation of fiscal and monetary policies
- Simple IS–LM Model
- Partial equilibrium and general equilibrium

9. Inflation and unemployment

Inflation

- Definition and types of inflation
- Causes of inflation: cost push and demand pull
- Effects of inflation
- Measures to control inflation

Unemployment

- Definition of unemployment
- Types and causes of unemployment
- Control measures of unemployment
- Relationship between unemployment and inflation: the Phillips curve

10. International trade and finance

- Definition of International trade
- Theory of absolute advantage and comparative advantage
- World trade organization (WTO) and concerns of developing countries
- Protection in international trade
- Regional integration organizations, commodity agreements and the relevance to less developed countries (LDCs)
- Terms of trade, balance of trade, balance of payments (causes and methods of correcting deficits in balance of payments), exchange rates, types of foreign exchange regimes, factors influencing exchange rates, foreign exchange reserves
- International financial institutions: International Monetary Fund (IMF) and World Bank
- National debt management: causes and interventions
- Structural Adjustment Programmes (SAPs) and their impacts on the LDCs

11. Emerging issues and trends

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Past papers

Suggested Answers

KASNEB

CPA PART I SECTION 2

CS PART I SECTION 2

CIFA PART I SECTION 2

CCP PART I SECTION 2

ECONOMICS

TUESDAY: 18 May 2021. **Time Allowed: 3 hours.**

Answer any FIVE questions. **ALL questions carry equal marks.**

QUESTION ONE

(a) Evaluate four ways in which the government could influence allocation of resources in a country. (8 marks)

(b) Explain using formulae, the difference between "arc elasticity" and "point elasticity" of demand. (4 marks)

(c) (i) Define the term "Consumer Sovereignty" as used in economics. (2 marks)

(ii) Summarise six limitations of consumer sovereignty in an economy. (6 marks)

(Total: 20 marks)

QUESTION TWO

(a) Highlight the effects of removing interest rate capping in an economy. (5 marks)

(b) Identify four reasons why governments intervene with the operations of price mechanism. (8 marks)

(c) Outline seven factors that influence the elasticity of supply of a commodity.

(7 marks)

(Total: 20 marks)

QUESTION THREE

(a) Using indifference curve analysis, demonstrate how an individual's equilibrium point is attained. (4 marks)

(b) With particular interest on inferior goods, use the indifference curve analysis to demonstrate and explain the income and substitution effect of a fall in price. (6 marks)

(c) Kenya, which is currently ranked as a developing country, came up with an economic blueprint geared towards realising economic development by the year 2030.

Required:

(i) Describe five factors that might hinder Kenya from realising the above objective. (5 marks)

(ii) Outline measures, that might be put in place in order to overcome the impediments in (c) (i) above. (5 marks)

(Total: 20 marks)

QUESTION FOUR

(a) Examine six causes of a deflationary gap in an economy. (6 marks)

(b) (i) Define the term "monetary policy". (2 marks)

(ii) Explain five objectives of monetary policy in an economy. (5 marks)

(c) Assess seven reasons why developing countries are concerned about the high rate of unemployment in their countries. (7 marks)

(Total: 20 marks)

QUESTION FIVE

(a) The total cost and demand functions of a firm operating under monopolistic competition are represented as follows:

$TC = 850 - 8Q + 10Q^2$

$P = 200$

Where:

TC = Total costs

Q = Output

P = Price

Required:

(i) Fixed cost function. (1 mark)

(ii) Variable cost function. (1 mark)

(iii) Average cost function. (1 mark)

(iv) Marginal cost function. (2 marks)

(v) Marginal revenue function. (2 marks)

(vi) The level of output at which the firm breaks-even. (3 marks)

(b) Examine five reasons for deteriorating terms of trade for developing countries. (10 marks)

(Total: 20 marks)

QUESTION SIX

(a) (i) Describe the term "economic integration". (2 marks)

(ii) Highlight six factors that limit successful economic integration in developing countries. (6 marks)

(b) Examine four advantages of currency devaluation to a country's economy.

(8 marks)

(c) With the use of a diagram, illustrate the optimal point of a firm. (4 marks)

(Total: 20 marks)

QUESTION SEVEN

(a) Enumerate seven roles of commercial banks in an economy (7 marks)

(b) (i) With a well labelled diagram, illustrate the concept of economic rent.(5 marks)

(ii) Explain how economic rent might be used as a good base for taxation. (3 marks)

(c) With the aid of a diagram distinguish between "actual economic growth" and "potential economic growth". (5 marks)

(Total: 20 marks)

KASNEB

CPA PART I SECTION 2

CS PART I SECTION 2

CIFA PART I SECTION 2

CCP PART I SECTION 2

ECONOMICS

TUESDAY: 24 November 2020. **Time Allowed: 3 hours.**

Answer any FIVE questions. **ALL questions carry equal marks.**

QUESTION ONE

(a) Explain four methods used by the government to stabilise agricultural prices. (4 marks)

(b) Using suitable examples, differentiate between the following terms as used in economics:

(i) "Basic human wants" and "secondary human wants". (4 marks)

(ii) "Public good" and "merit good". (4 marks)

(iii) "Stable equilibrium" and unstable equilibrium". (4 marks)

(c) With the aid of a well labelled diagram, illustrate the effect of a simultaneous increase in the income of the consumer and increase in fuel prices. (4 marks)

(Total: 20 marks)

QUESTION TWO

(a) With the help of a diagram, discuss the concept of an individual engel curve as applied in the theory of consumer behaviour. (5 marks)

(b) Citing four examples, explain the significance of mobility of factors of production.

(8 marks)

(c) A firm uses two factors of production, labour and capital in the long-run. The price per unit of labour is Sh.1,200 while the price per unit of capital is Sh.900. The firm has a budget of Sh.72,000 which it uses entirely on labour and capital to produce an output level of 500,000 tons.

Required:

(i) With the help of a diagram, derive the optimal point of the firm. (4 marks)

(ii) Determine the firm's marginal rate of technical substitution (MRTS).(3 marks)

(Total: 20 marks)

QUESTION THREE

(a) Examine three sources of monopoly power. (6 marks)

(b) With the aid of a well labelled diagram, explain the equilibrium level of a firm operating under monopolistic market structure in the long run. (6 marks)

(c) Assume that a producer has the possibility of discriminating between the domestic and foreign markets for a product with the demand functions given as follows:

$Q_1 = 16 - 0.2P_1$ (Domestic market)

$Q_2 = 90 - 0.5P_2$ (Foreign market)

Total Cost (TC) of production is given as:

TC = 50 + 20Q

Required:

Determine the level of output and price to be charged for:

(i) Domestic market. (4 marks)

(ii) Foreign market. (4 marks)

(Total: 20 marks)

MAY 2021

SUGGESTED ANSWERS AND SOLUTIONS

QUESTION ONE

(a) Ways in which the government could influence allocation of resources in a country. (May 2016 1B and 1C)

- **Indirect taxes:** indirect taxes can be used to raise the price of de-merit goods and products with negative externalities designed to increase the opportunity cost of consumption and thereby reduce consumer demand towards a socially optimal level.
- **Subsidies:** subsidies to consumers will lower the price of merit goods. They are designed to boost consumption and output of products with positive externalities – remember that a subsidy causes an increase in market supply and leads to a lower equilibrium price.
- **Provision of goods and services:** Because of privatization, the state owned sector of the economy is much smaller than it was years ago. State funding can also be used to provide merit goods and services and public goods directly to the public.
- **Tax relief:** the government may offer financial assistance such as tax credits for business investment in research and development. Or a reduction in corporation tax designed to promote new capital investment and extra employment.
- **Legislation and regulation** e.g. employment laws may offer some legal protection for workers by setting maximum working hours or by providing a price-floor in the labor market through the setting of a minimum wage regulation may be used to introduce fresh competition into a market- for example breaking up the existing monopoly power of service provider.

(b) Difference between "arc elasticity" and "point elasticity" of demand.

- **Arc elasticity** – refers to the average elasticity between two given points on the curve.

$$\text{Arc PED} = \frac{Q_2 - Q_1}{(Q_2 + Q_2) \div 2} \times \frac{(P_1 + P_2) \div 2}{P_2 - P_1}$$

- **Point elasticity** – this measures elasticity at a particular point and is only valid or based on small movements.

$$PED = \frac{\Delta Q}{\Delta P} \times \frac{P}{Q}$$

(c) (i) Term "Consumer Sovereignty" as used in economics. (Nov 2018 1B)

This is an economic belief that societal welfare is maximized when consumers are at liberty to choose goods to satisfy their needs .Simply, the consumer is the best judge of their product choices**.**

(ii) Limitations of consumer sovereignty in an economy.

- Government policy through taxes and subsidies can influence choices made by consumer.
- Nature of economic system e.g. in a command economy, government dictates what a consumer should do.
- Irrationality of consumer
- Advertising also restricts the consumer's choice.
- Type of market e.g. in monopolies consumers have limited choice.
- Income of consumer products are only made for rich guy and the choices of the poor are never considered
- In availability of goods means consumers has to use what is available.
- Technical factors may impinge on freedom of consumer. For example the existing technology may not allow producers to make goods desired by consumers.
- Habit individual consumers have different and are reluctant to charge

QUESTION TWO

(a) Effects of removing interest rate capping in an economy / Impact of interest rate decontrol in an economy