

STRICTLY CONFIDENTIAL

**THE PUBLIC ACCOUNTANTS EXAMINATION
COUNCIL OF MALAWI**

2014 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 5: ECONOMICS

WEDNESDAY 28 MAY 2014

**TIME ALLOWED: 3 HOURS
2.00 PM – 5.00 PM**

SUGGESTED SOLUTIONS

1. (a) Opportunity cost is the amount of one product that must be forgone in order to obtain the other.

- (b) Given the following statistics:

Cars (000's)	0	3	6	9	12
Boats (000's)	10	9	7	4	0

- (i) The opportunity cost of producing the first 3000 cars is 9000 boats.
- (ii) The opportunity cost of producing 10,000 boats is 12,000 cars.
- (iii) The opportunity cost of producing the 10,000th boat is 3000 cars.

- (c) The **four** factors of production and their respective rewards are as follows:

- (i) Land and its reward when used in production is rent.
- (ii) Labour and its reward when used in production is wages or salaries.
- (iii) Capital and its reward when used in production is interest.
- (iv) Entrepreneurship and its reward when used in production is profit.

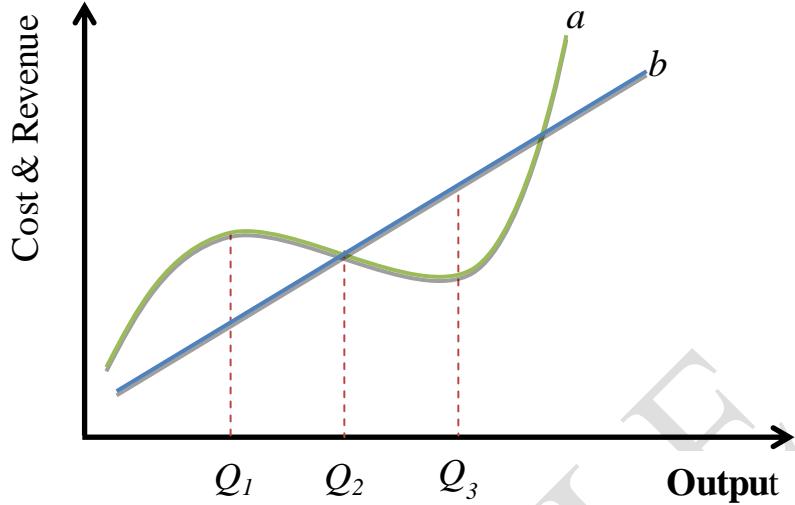
- (d) Allocative efficiency occurs when all available resources are devoted to the production of goods most wanted by society while productive efficiency occurs when goods are produced using the lowest cost production methods.

2. (a) Individuals in a partnership have unlimited liability while in a joint stock company have limited liability.

- (b) **Four** disadvantages of sole proprietorship are as follows:

- (i) The company may lack the necessary expertise.
- (ii) The business owner has unlimited liability.
- (iii) A sole proprietor may not have enough capital.
- (iv) The business is likely to die with the owner.

- (c) **Two** reasons that may motivate a firm to grow include:
- (i) In order to reduce their average costs.
 - (ii) To diversify, producing a wider range of products in order to ensure their long-term survival.
- (d) The difference between vertical and horizontal integration is that vertical integration occurs when firms amalgamate at different stages of the productive process while horizontal integration occurs when a firm amalgamates with another firm at the same stage of the productive process.
- (e) **Three** sources of economies of scale include the following:
- (i) **Technical economies** arise from increased use of specialization and from mechanization, automation and computerization.
 - (ii) **Administrative economies** are said to occur when, as firms grow larger, the specialist skills of particular managers are used to a greater effect, and more sophisticated decision-making techniques are introduced.
 - (iii) **Financial economies** refer to situations in which large-scale firms find it easy to borrow money at favourable rates of interest as financial institutions are willing to loan on preferential terms to large, well-known companies.
- (f) Economies of scope refer to the reduction in average total cost made possible by a firm increasing the number of products it produces.
3. (a) The points are as follows:
- (i) $a = 30$
 - (ii) $b = 25$
 - (iii) $c = 20$
 - (iv) $d = 60$
 - (v) $e = 0$
- (b) The alternative term for average revenue is ‘price’.
- (c) Short-run profit maximization in perfect competition.

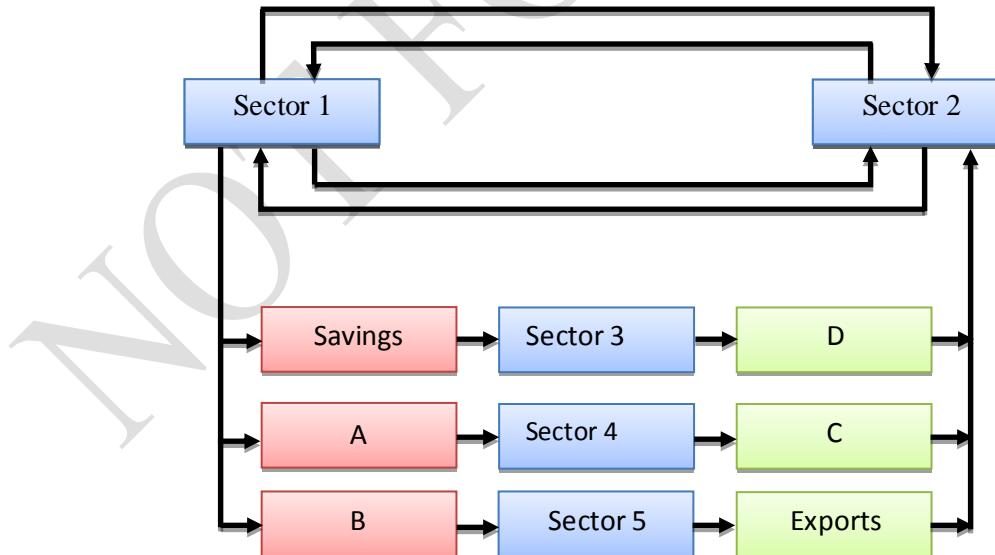


- (i) **a** is total cost curve while **b** is total revenue curve.
- (ii) The firm maximizes its profits at Q_3 .
- (iii) The firm breaks even at Q_2 .
- (iv) The firm minimizes its marginal costs at Q_2 .
- (v) The firm's marginal costs are equal marginal revenue for the second time at Q_3 .
- (d) **Four** characteristics of oligopolistic markets are as follows:
- (i) The market tends to have few large firms.
- (ii) Usually, there are a large number of product brands in the market.
- (iii) There are many buyers in the market.
- (iv) Firms tend to engage in non-price competition.
4. (a) Market failure refers to a situation in which a free market mechanism fails to produce a satisfactory allocation of resources.
- (b) The following are **three** factors that will lead to market failure:
- (i) Imperfections in the market.
- (ii) A divergence between private costs and social costs.
- (iii) Provision of public goods.
- Note:** Other points may be considered.
- (c) To explain how the following would bring about market imperfection:

- (i) Monopsony buyers are large individual buyers who dominate demand in a market. Monopsonists can control the market by extracting low prices or other favourable conditions from suppliers.
 - (ii) In the case of time lags, it takes time for the price mechanism to work. Firms cannot suddenly enter a new market or shut down operations. The slow response of the price mechanism to changes in demand creates some short-term inefficiency in resource allocation.
 - (iii) Monopoly markets are those markets that are dominated by one large firm. In such markets, a change in the price of a good might not result in the most efficient switch of resources.
- (d) **Three** ways in which a government might choose to regulate markets are:
- (i) By controlling the means of production.
 - (ii) By providing public goods.
 - (iii) By providing some goods in greater quantities than there would be if an entirely free market operated.

Note: Other points may be considered.

5. A simple five sector circular flow model



- (a) Sector 1 is households, sector 2 is firms, sector 3 is the financial sector, sector 4 is the government and sector 5 is the rest of the world.
- (b) The names of the flows are as follows: A is taxes, B is imports, C is government spending and D is investment expenditure.

- (c) The equilibrium equation for this model is given as follows:
 $Savings + A + B = D + C + Exports$
- (d) If Savings = 100, A = 500, B = 200, Exports = 300, C = 600, D = 100, then injections exceed leakages by 200.
- (e) When leakages exceed injections, the economy will contract.
- (f) **Five** assumptions of a basic circular flow of income model include the following:
- (i) The economy consists of two sectors: households and firms.
 - (ii) Households spend all of their income on goods and services.
 - (iii) All output produced by firms is purchased by households.
 - (iv) There is no financial sector.
 - (v) There is no government sector.

Note: Other points may be considered.

6. (a) A simple theoretical economy's gross domestic product (GDP) expressed in US\$.

Wages and salaries (W)	\$800
Interest (N)	\$400
Private Consumption expenditure (C)	\$300
Government expenditure (G)	\$1000
Imports (M)	\$30
Exports (X)	\$20
Profits (P)	\$80
Rent (R)	\$60
Investment expenditure (I)	\$50

- (i) GDP is the total market value of all final products produced in the economy during a specific period, usually one year.
- (ii) Using the income approach, the economy's GDP is:

$$W + N + P + R = \$800 + \$400 + \$80 + \$60 = \$1340.$$
- (iii) Using the expenditure approach, the economy's GDP is:

$$C + I + G + X - M = \$300 + \$50 + \$1000 + \$20 - \$30 = \$1340.$$
- (iv) GDP measured using the income approach does NOT differ from GDP measured using the expenditure approach.
- (b) **Four** weaknesses of using national income per capita as a guide to comparing the standard of living in different countries are as follows:
- (i) In measuring GNP, 'products' include goods and services that are paid for but exclude work done by a person for oneself. It also excludes barter trade; as such total GNP of various countries would not be properly comparable.
 - (ii) Spending on items which produce a benefit over several years is included in GNP in one year only, which is the year the expenditure takes place. If a country is enjoying benefits from past investments, this will not be reflected in its current GNP.
 - (iii) Every country will have difficulties in obtaining accurate data about output and GNP. For instance, a country with a strong black economy will be much wealthier than its official GNP per head might suggest.
 - (iv) The needs of people in one country will differ widely from the needs of people in another country.
- Note:** Other points may be considered.
7. (a) Budget deficit occurs when government expenditure exceeds its revenue.
- (b) (i) **Two** direct taxes can be named and explained as follows:
- Personal income tax-** is the tax levied on the financial incomes of persons.
- Corporate or corporation tax -** is the tax levied on the income of companies.
- (ii) **Two** indirect taxes can be named and explained as follows:
- Value Added tax-** is the tax levied on some consumable goods.

Import duty - is the tax levied on some imports.

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- (c) Crowding-out effect occurs when high interest rates, resulting from huge government borrowing, deter certain kinds of private investment spending.
- (d) **Four** arguments against public debt in Malawi would include:
 - (i) The debt incurred by the present generation will have to be repaid by future generations, including the interest on the debt.
 - (ii) A certain percentage of the national debt is held externally (overseas) which, in turn, can be viewed as a real burden on the economy in terms of an outflow from Malawi of the final redemption and interest repayments.
 - (iii) The existence of national debt implies that the level of taxation is higher than it would be if the national debt did not exist.
 - (iv) There are costs incurred in administering the national debt and, although these costs are only a small proportion of GDP, these resources could have been used elsewhere in the economy.

Note: Other points may be considered

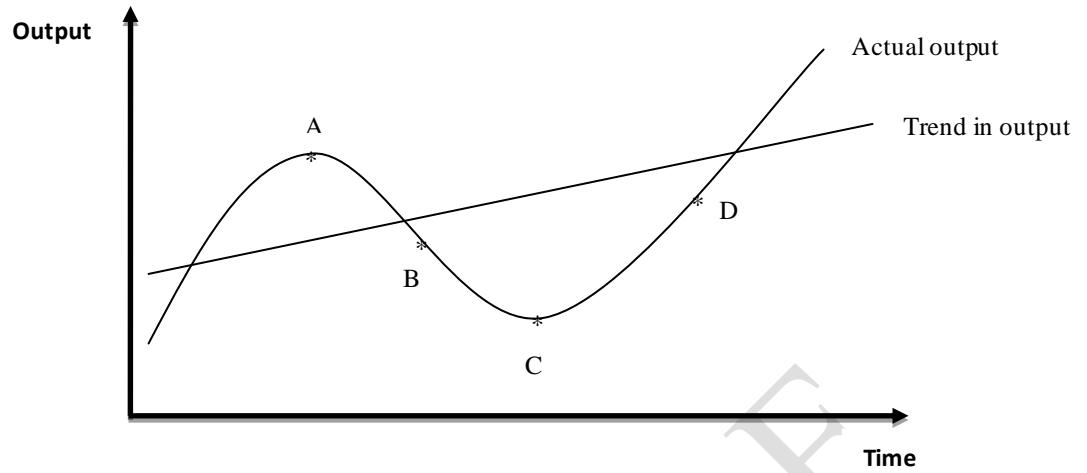
8. (a) Investment can be described as committing resources (factors of production) to a long-term project with a view to earning a satisfactory return over the period of the project.

Note: Some other definitions can be considered

- (b) **Five** factors that influence the volume of investment in a particular country are:
- (i) The expected return from investments.
 - (ii) Interest rates.
 - (iii) New technology and methods of production.
 - (iv) The availability of government grants or subsidies.
 - (v) Political stability of a country .

Note: some other points may be considered.

- (c) The relationship between investment and the business cycle



From the above figure, points A, B, C and D can be explained as follows:

- (i) A is peak. This is where economic activity has reached a temporary maximum. The economy is at full employment.
- (ii) B is recession. This is a period where growth rates in the levels of output and employment both decline over two or more successive quarters.
- (iii) C is trough. This is where output and employment growth are at their lowest levels.
- (iv) D is recovery. This is where the economy's levels of output and employment expand towards full employment.

- (d) **Five** characteristics of recession include:

- (i) A fall off in consumption levels.
- (ii) Many investments become unprofitable.
- (iii) Production falls.
- (iv) Employment falls.
- (v) The price level may fall if recession is severe (depression).

Note: some other points may be considered.

9. (a) Market liberalization is a macroeconomic policy reform that is aimed at allowing market forces to drive allocation in production.
- (b) **Three** advantages of liberalizing the passenger transport industry may include:

- (i) The liberalized passenger transport industry is likely to promote competition leading to better or high quality services.
- (ii) Since producers are motivated by profit there will be an incentive to respond quickly to changes in consumers' preferences.
- (iii) By using the 'money votes' passengers will be able to dictate to the transport providers what kind of service is provided.

Note: Other points may be considered.

- (c) The kind of unemployment that these people may be referring to is **classical unemployment**.

Classical or real-wage unemployment occurs when real wages for a job are set above the market-clearing level, causing the number of job-seekers to exceed the number of vacancies. Prior to liberalization, the passenger transport sector was state controlled employing at, at least, a minimum wage, usually above the market clearing level. With liberalization, many people are employed even at below minimum wage which has helped mop out unemployment.

- (d) According to John Maynard Keynes, 'prices are sticky downwards'. This implies that once prices go up they are very unlikely to go down. In view of this, the fares of most passenger transport services may not necessarily go down irrespective of the market liberalization.

- (e) **Four** advantages of protectionism are as follows:

- (i) It helps to protect infant industry.
- (ii) It helps to prevent dumping.
- (iii) It can protect local citizens from foreign undesirable products.
- (iv) It helps raise revenue (through import duties) for the government.

Note: Other points may be considered

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