



Institute of Actuaries of India

Subject
CB2 - Business Economics
Core Principles

For 2024 Examinations

CB2 Business Economics

Syllabus for the 2024 Examinations

This syllabus includes information to support the study of this subject. It will guide you through what you need to learn, application of learning as well as the skills that you need to develop. Information regarding the assessment of this subject is also included.

This syllabus includes:

- Aim of the subject
- How this subject links across the Qualifications
- Subject topics and topic weightings
- Subject objectives
- Assessment information

Aim

Business Economics introduces the core economic principles and how these can be used in a business environment to help inform decision-making and behaviour. It includes the fundamental concepts of microeconomics that explain how economic agents make decisions and how these decisions interact. It also explores the principles underlying macroeconomics that explain how the economic system works and how decisions taken by economic agents affect the financial system and relevant aggregate economic and financial variables.

Links across the Qualifications

Associateship Qualification

Business Economics (CB2) is a fundamental subject contributing to the foundations of the Associateship Qualification. Knowledge gained from this subject is implicitly assumed and applied across many other subjects, in particular:

- Business Finance (CB1)
- Business Management (CB3)
- Financial Engineering and Loss Reserving (CM2)
- Actuarial Practice (CP1)

Fellowship Qualification

An understanding of Business Economics may be required for any of the Specialist Advanced (SA) examinations, as these examinations tend to focus on “real world” scenarios, and the subject is particularly relevant for the potential scenarios presented in Investment & Finance Specialist Principles (SP5), Pensions & Other Benefits (SA4) and Investment & Finance (SA7) examinations. Economic judgement should be applied and considered across all Specialist Principles (SP) and Specialist Advanced (SA) subjects.

Topics and Topic Weightings

1. Economic schools, the economic way of thinking and recent historical applications [5%]
2. Microeconomics [40%]
3. Macroeconomics [55%]

Objectives

1 Economic schools, economic way of thinking and recent historical applications [5%]

An introduction to economic concepts and models, their use in business as well as recent economic and financial history.

1.1 Relationship between economics and business

- 1.1.1 Principles of economic choice, including opportunity cost and scarcity
- 1.1.2 Core economic concepts used by businesses to make choices relevant to selection of outputs, inputs, technology, location and competition
- 1.1.3 Features of and differences between microeconomics and macroeconomics

1.2 Main economic schools and their key features:

- Classical
- Marxian socialism
- Neo-classical, Keynesian, neo-Keynesian and post-Keynesian
- Monetarist
- Austrian.

1.3 Recent macroeconomic history

- 1.3.1 Progress of the world economy since the Great Depression, with a particular focus on banking crises, their consequences and irrational behaviour
- 1.3.2 Banking crisis of 2008, the Great Recession, and recovery, including:
 - Effectiveness of monetary policy in the 2008 financial crisis
 - Governments actions to combat recession
 - Aftershocks in Europe
 - Stimulus-austerity debate and regulatory action after the 2008 crisis

2 Microeconomics - the behaviour of consumers, firms and markets [40%]

Understand, in detail, models of consumer choice, the theory of the firm and how these affect business decisions under different conditions.

2.1 How competitive markets operate

- 2.1.1 Role of the price mechanism and the behaviour of firms and consumers in a free market
- 2.1.2 Factors that influence market demand and supply
- 2.1.3 How market equilibrium quantity and price are achieved
- 2.1.4 How markets react to changes in demand and supply

- 2.1.5 Calculation of price and income elasticities of demand and price elasticity of supply, using both original and average quantities
- 2.1.6 Factors that affect elasticity
- 2.1.7 Effect of elasticity on the short- and long-term operation of markets
- 2.1.8 How firms deal with risk and uncertainty about future market movements
- 2.1.9 Price expectations and speculation and how price bubbles develop
- 2.2 Consumer demand and behaviour
 - 2.2.1 The concept of utility and the representation of consumer preferences as indifference curves
 - 2.2.2 How rational choice and optimal consumption choice is determined by using indifference curves and budget lines
 - 2.2.3 Rational choice, perfect information and irrational behaviour in the context of behavioural economics
- 2.3 The impact of advertising on sales and demand
- 2.4 Impact of the production function, costs of production and revenue and profit to on a firm's price and output decisions
 - 2.4.1 The production function and the relationship between short- and long-term inputs and outputs
 - 2.4.2 Average and marginal physical product
 - 2.4.3 Meaning and measurement of costs and how these vary with short- and long-term output
 - 2.4.4 Total, average and marginal costs
 - 2.4.5 Economies of scale and how a business can achieve efficiency in selecting the level of its inputs
 - 2.4.6 Revenue and profit and how they are influenced by market conditions
 - 2.4.7 Calculation of average and marginal revenue
 - 2.4.8 Measurement of profit and how a firm arrives at its profit-maximising output
 - 2.4.9 The 'shut-down' point in the short and long run
- 2.5 Profit maximisation under perfect competition and monopoly
 - 2.5.1 What determines the market power of a firm
 - 2.5.2 Main features of a market characterised by perfect competition, including how output and price are determined in the short and long term
 - 2.5.3 Monopolies and how they emerge; how they select profit-maximising price and output; and the determination of the profit of a monopolist
 - 2.5.4 Barriers to entry and market contestability and their impact on the profit of a monopolist
- 2.6 Profit maximisation under imperfect competition
 - 2.6.1 Behaviour of firms under monopolistic competition and why in this type of market only normal profits are made in the long run
 - 2.6.2 Main features of an oligopoly and the behaviour of firms in an oligopoly
 - 2.6.3 Competition and collusion of firms in an oligopoly and how strategic decisions of such firms can be explained by game theory
 - 2.6.4 Behaviour of oligopolists and the consumer interest
- 2.7 Pricing strategies that firms in the financial services sector can adopt

- 2.7.1 How prices are determined in practice and factors that affect the ability of a firm to determine its prices
- 2.7.2 Average-cost pricing and price discrimination
- 2.7.3 Pricing strategy for multiple products and how pricing varies with the stage in the life of a product

3 Macroeconomics and the role of government [55%]

Understand aggregate economic variables and concepts which relates them to government policy, business decision making and financial market variables.

- 3.1 Government intervention in a market
 - 3.1.1 Extent to which businesses meet the interests of consumers and society in general
 - 3.1.2 Socially efficient' perfect markets and why most markets fail to achieve the theoretical ideal of social efficiency
 - 3.1.3 Why externalities can lead to inefficient markets
 - 3.1.4 How governments intervene in markets to influence business behaviour and the drawbacks of such intervention
 - 3.1.5 Role of taxation and regulation in correcting shortcomings in markets
 - 3.1.6 Why government intervention might not improve market outcomes in practice even if the existence of 'market failures' suggest they can in theory
 - 3.1.7 Policy instruments that can be used to promote environmental sustainability
- 3.2 Relationship between the government and the individual firm
 - 3.2.1 Main targets of 'competition policy' and the extent to which it is effective
 - 3.2.2 Why a free market can fail to achieve the optimal amount of research and development
 - 3.2.3 Government intervention to encourage technological advance and innovation
- 3.3 Globalisation and multinational business
 - 3.3.1 Globalisation and its impact on business
 - 3.3.2 The driving processes of globalisation and the benefit of globalisation
- 3.4 Importance of international trade
 - 3.4.1 Growth of international trade and its benefits to countries and firms
 - 3.4.2 Advantages of specialisation
 - 3.4.3 Arguments for trade restriction and protection of domestic industries
 - 3.4.4 Role of the World Trade Organization (WTO) in international trade
- 3.5 Impact of the macroeconomic environment on business
 - 3.5.1 Main macroeconomic variables that governments seek to control
 - 3.5.2 Impact of an economic stimulus on business output
 - 3.5.3 Difference between actual and potential growth
 - 3.5.4 Factors that determine economic growth and the reasons for differences in different nations' growth rates
 - 3.5.5 Why economies experience periods of boom followed by periods of recession and the factors that influence the length and magnitude of the phases of a business cycle

- 3.5.6 Causes and costs of unemployment and its impact on the level of business activity
- 3.5.7 Determination of the price level in the economy by the interaction between aggregate supply(AS) and aggregate demand (AD) in a simple AS-AD model
- 3.5.8 Causes and costs of inflation and its impact on the level of business activity
- 3.5.9 Gross domestic product (GDP) and its measurement
- 3.5.10 Representation of the economy as a simple model of the circular flow of income
- 3.6 Balance of payments and the determination of exchange rates
 - 3.6.1 What is 'the balance of payments' and how trade and financial movements affect it
 - 3.6.2 How exchange rates are determined and their impact on business
 - 3.6.3 Relationship between the balance of payments and exchange rates
 - 3.6.4 Advantages and disadvantages of fixed and floating exchange rates
 - 3.6.5 How governments and/or central banks seek to influence the exchange rates and the implications of such actions for other macroeconomic policies and for business
 - 3.6.6 Purpose and effectiveness of monetary union and single currencies, with reference to the European Economic and Monetary Union, the Exchange Rate Mechanism and the creation of a single Currency
- 3.7 Role of money and interest rates in the economy
 - 3.7.1 Functions of money
 - 3.7.2 Factors that determine the amount of money in the economy, what causes it to grow and the role of banks in this process
 - 3.7.3 Concept of the money multiplier
 - 3.7.4 Determination of interest rates
 - 3.7.5 Relationship between money and interest rates
 - 3.7.6 Why central banks play a crucial role in the functioning of economies
 - 3.7.7 How a change in the money supply and/or interest rates affects the level of business activity
- 3.8 Role, structure and stability of the financial system
 - 3.8.1 Functions of the financial sector
 - 3.8.2 Role and functions of investment funds, banks and insurance companies/pension funds.
 - 3.8.3 Different ways banks and insurance companies can be exposed to credit risk and liquidity risk through:
 - bank loans
 - corporate bonds
 - securitisations (which can be owned by the non-bank sector)
 - syndicated loans
 - credit derivatives
 - 3.8.4 Why the banking sector is more likely to be exposed to systemic risk than the non-bank financial sector
 - 3.8.5 How financial innovation could lead to some functions of the banking sector being performed by non-banks
 - 3.8.6 Basic principles on which Islamic finance is based

- 3.8.7 Evaluation of the features of an Islamic finance product against the principles of Islamic finance
- 3.9 Factors that determine the level of business activity and how they also affect unemployment and inflation
 - 3.9.1 Determination of the equilibrium level of income within a simple aggregate demand-expenditure model
 - 3.9.2 Concept of the multiplier and the calculation of its value
 - 3.9.3 Impact of a rise in money supply on output and prices
 - 3.9.4 Relationship between unemployment and inflation and whether the relationship is stable
 - 3.9.5 How business and consumer expectations affect the relationship between unemployment and inflation and the formation of such expectations are formed
 - 3.9.6 Inflation targeting and its effect on the relationship between unemployment and inflation
 - 3.9.7 Course of a business cycle and its turning points
 - 3.9.8 Whether the business cycle is caused by changes in aggregate demand or changes in aggregate supply (or both)
- 3.10 Impact of macroeconomic policies on businesses
 - 3.10.1 Types of macroeconomic policy that are likely to have an impact on business and the way in which this impact takes effect
 - 3.10.2 Impact of fiscal policy on the economy and business and the factors that determine its effectiveness in smoothing out economic fluctuations
 - 3.10.3 Fiscal rules and their efficacy
 - 3.10.4 How monetary policy works in the UK and the eurozone and the roles of the Bank of England and the European Central Bank
 - 3.10.5 Targeting inflation to influence interest rates and the economic activity
 - 3.10.6 The merits of central banks following a simple inflation target and possible alternatives
- 3.11 Supply-side policies and their impact on businesses
 - 3.11.1 Effect of supply-side policies on business and the economy
 - 3.11.2 Types of supply-side policies that can be pursued and their effectiveness
 - 3.11.3 Impact of cutting taxes on business
 - 3.11.4 Major forms of government policy that can be used to encourage competition

Assessment

Three-hours and fifteen-minutes assessment using objective test questions and 'free form' answer questions.

END