

ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව  
 இலங்கைப் பரீட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம்  
 Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka  
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අධ්‍යයන භෞද්ධ සහතික පත්‍ර (උසස් පෙළ) විභාගය, 2016 අගෝස්තු  
 கல்விப் பொதுத் தராதரப் பத்திர (உயர் தர)ப் பரீட்சை, 2016 ஓகஸ்ட்  
 General Certificate of Education (Adv. Level) Examination, August 2016

ආර්ථික විද්‍යාව I  
 பொருளியல் I  
 Economics I

21 E I

පැය දෙකයි  
 இரண்டு மணித்தியாலம்  
 Two hours

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1st Examiner		
2nd Examiner		
Addl. Chief		
E.M.F.		
Chief		

Instructions:

- \* Answer all the questions on this question paper itself.
- \* Write your Index Number in the space provided in the answer sheet.
- \* Select the correct answers for questions No. 1-50 and write its number on the dotted line given.

- The concept of 'scarcity' in economics refers to a condition where
  - society is not utilizing all of its available resources in an efficient manner.
  - people's wants can never be satisfied by the available resources.
  - some members of each society live in poverty.
  - too many frivolous goods and services are produced at the expense of socially desirable goods and services.
  - production is efficient, but distribution is inefficient. (.....)
- The production possibilities boundaries are drawn concave to the origin to reflects the
  - decreasing opportunity cost of producing more of either good.
  - scarcity of resources in the economy.
  - constant opportunity cost of producing more of either good.
  - unfair distribution of resources in the economy.
  - increasing opportunity cost of producing more of either good. (.....)
- In a free market economy, which of the following is **incorrect**?
  - Prices allocate resources equally among competing production sectors in the economy.
  - Prices indicate relative scarcities and costs of production of goods and services.
  - Relative price changes are a determinant of firms' profits and therefore encourage or discourage production.
  - Prices are measures of consumers' willingness to pay for goods and services.
  - Prices signal to consumers how much they must sacrifice to obtain a commodity. (.....)
- In a competitive market with no externalities, allocative efficiency would exist if prices equal
  - total cost in all markets.
  - marginal revenue in all markets.
  - marginal costs in all markets.
  - average variable cost in all markets.
  - the value of marginal product. (.....)

[See page two

5. The term 'human capital' refers to
- (1) the labour resource used to make capital equipment.
  - (2) buildings and machinery.
  - (3) the skill and knowledge endowment of labour force.
  - (4) entrepreneurship and risk-taking ability.
  - (5) labour force employed in the health and education sectors. (.....)

6. Potential output is
- (1) the maximum GDP that an economy actually achieved during the last ten years.
  - (2) achieved during periods when all of the labour force is employed in tradable goods producing sector.
  - (3) a goal that can never be achieved by the economy using all its resources most efficiently.
  - (4) the GDP that could be produced when the economy's resources were fully employed at a normal intensity of utilization.
  - (5) the GDP that could be produced when the economy's resources were fully employed at a maximum intensity of utilization. (.....)

7. Suppose X is an inferior good and sold in a competitive market. Assuming other things remain constant in the market for X, what are the effects of a decrease in income of buyers on the demand, equilibrium price and the equilibrium quantity, in the market for X?

	Demand	Price	Quantity
(1)	decreases	decreases	decreases
(2)	increases	increases	increases
(3)	decreases	increases	decreases
(4)	increases	decreases	decreases
(5)	decreases	increases	increases

(.....)

8. The Table below shows the market demand schedule and the supply schedules for a good before and after the imposition of a specific (per unit) tax on an essential commodity:

Price (Rs.)	Quantity Demanded	Quantity supplied before tax	Quantity supplied after tax
12	50	20	0
13	50	30	10
14	50	40	20
15	50	50	30
16	50	60	40

What was the tax per unit of output?

- (1) Rs. 2      (2) Rs. 3      (3) Rs. 4      (4) Rs. 5      (5) Rs. 6      (.....)

9. The price elasticity of demand for ballpoint pen is -3.0. When the price of a ballpoint pen is Rs. 25, quantity demanded is 300 pens. How much will be demanded when the price falls to Rs. 20?

- (1) 900      (2) 630      (3) 560      (4) 480      (5) 180      (.....)

10. The market supply curve for some good or service would shift to the left when

- (1) technology improves.
- (2) the prices of inputs fall.
- (3) the prices of inputs increase.
- (4) technology improves and the price of inputs falls.
- (5) more suppliers enter the industry. (.....)

11. The supply curve of good X is given by the following equation:

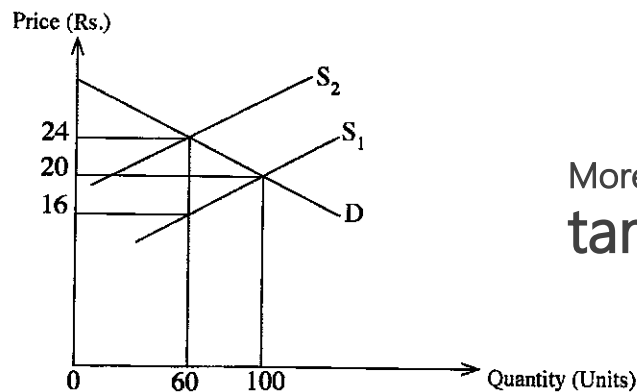
$$Q_x = 6P_x$$

where  $Q_x$  is the quantity supplied and  $P_x$  is the price of the good X. What can be deduced from this equation regarding the price elasticity of supply of good X?

- (1) Price elasticity of supply is 6.0
- (2) Price elasticity of supply is 1.0
- (3) Price elasticity of supply is 0.1
- (4) Price elasticity of supply is 0.0
- (5) Price elasticity of supply is 0.6 (.....)

[See page three]

12. The diagram below shows an increase in supply from  $S_2$  to  $S_1$  after the removal of a specific tax imposed on the good X. Supply curve  $S_1$  was the pre-tax supply curve as well as the supply curve after removal of the tax.



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What effect does the removal of the tax have on tax revenue and consumer expenditure?

	Tax revenue	Consumer expenditure
(1)	decrease by 1 440	increase by 2 000
(2)	decrease by 480	decrease by 560
(3)	decrease by 480	increase by 560
(4)	increase by 960	increase by 1 440
(5)	decrease by 1 440	decrease by 960

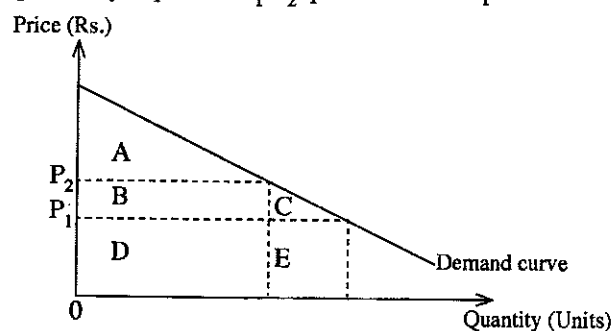
(.....)

13. The substitution effect is the change in quantity demanded that occurs as a result of

- (1) a change in relative price, with other things remain constant.
- (2) a change in absolute prices, with real income held constant.
- (3) changing relative prices with money income held constant.
- (4) a change in real income when relative prices are held constant.
- (5) a change in money income when the relative price remains unchanged.

(.....)

14. The diagram below shows a country's demand curve for an imported consumer good. The government of this country imposes an import duty equal to  $P_1 - P_2$  per unit of output.

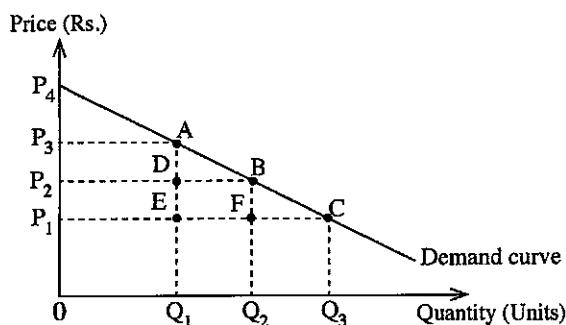


Which areas of the diagram measure the resulting loss of consumer surplus and the resulting gain in government revenue?

	Loss in consumer surplus	Government gain in tax revenue
(1)	A + B	B + C
(2)	A + B + C	B
(3)	A + B	B + C + D + E
(4)	D	B + D
(5)	B + C	B

(.....)

15. The diagram below shows market demand curve for a product.



Assume that the supply is perfectly elastic and the price of this product is initially  $P_1$ . If the price increases from  $P_1$  to  $P_2$  due to a tax levied on the product the excess burden of the tax is

- (1) the area  $P_3AP_4$ . (2) the area  $ADB$ . (3) the area  $P_1P_4C$ .  
 (4) the area  $P_1CBP_2$ . (5) the area  $BFC$ . (.....)

16. When a firm increases all its inputs by 50%, its output increases by 40%. This situation is illustrated as the Law of

- (1) diminishing returns. (2) decreasing returns to scale. (3) variable proportions.  
 (4) increasing returns to scale. (5) marginal returns. (.....)

17. In the price range below minimum average variable cost, a perfectly competitive firm's supply curve is

- (1) horizontal at the market price.  
 (2) vertical at zero output.  
 (3) the same as the firm's marginal cost curve.  
 (4) the same as the firm's average variable cost curve.  
 (5) upward rising with positive output. (.....)

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18. The profit maximizing output of a firm operating in a competitive market is determined at a point where

- (1) marginal cost is decreasing. (2) marginal cost is increasing.  
 (3) marginal revenue is increasing. (4) marginal cost is at its minimum level.  
 (5) marginal cost is below the marginal revenue. (.....)

19. In the short run, if a firm produces nothing, which of the following costs will be zero?

- (1) Opportunity cost (2) Total variable cost (3) Total fixed cost  
 (4) Average total cost (5) Total cost (.....)

20. One of the 'real' flows in the circular flow model of income is

- (1) the flow of goods and services going from firms to households.  
 (2) the flow of factor services going from firms to households.  
 (3) the flow of goods and services going from households to firms.  
 (4) the flow of money payments going from firms to households.  
 (5) the flow of money payments going from households to firms. (.....)

21. Suppose in a given country, the general level of prices has risen in the past year, but production of goods and services has remained constant. Based on this information, which of the following is correct?

	Nominal GDP	Real GDP
(1)	increased	increased
(2)	unchanged	unchanged
(3)	decreased	decreased
(4)	increased	unchanged
(5)	decreased	increased

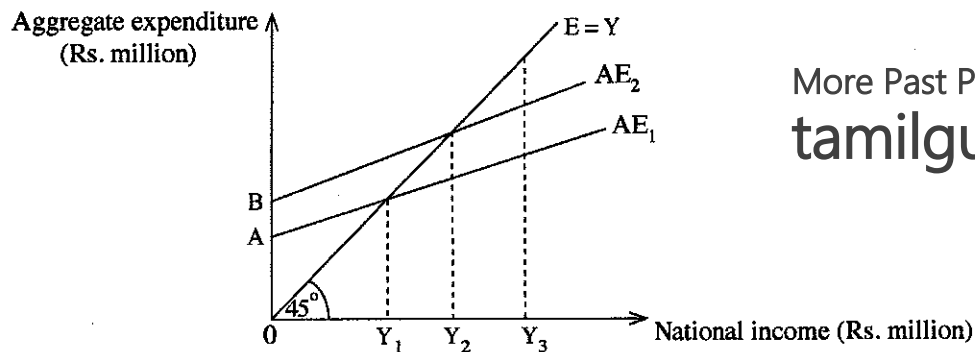
(.....)

22. Which of the following is included in the calculation of personal income, but not in national income?

- (1) Corporate dividends (2) Transfer payments  
 (3) Social security contributions (4) Undistributed corporate profits  
 (5) Net interest (.....)

[See page five]

23. Assume that in a simple economy, the aggregate consumption function is  $C = 250 + 0.75Y$  and investment is  $I = 450$ . The equilibrium level of income in this economy is  
 (1) 1 800. (2) 2 800. (3) 3 600. (4) 7 200. (5) 9 000. (.....)
24. An increase in which of the following will increase the value of the investment multiplier?  
 (1) The supply of money (2) Equilibrium output  
 (3) Personal income tax rates (4) The marginal propensity to consume  
 (5) The statutory reserve ratio (.....)
25. Which one of the following represents an injection into an economy's circular flow of income?  
 (1) A deficit in the trade balance (2) A government budget deficit  
 (3) An increase in net taxes (4) Retained profits of private companies  
 (5) Household savings (.....)
26. The diagram below displays the behaviour of some macroeconomic variables in an economy.



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- If the national income of this economy is  $Y_3$  and the aggregate expenditure function is  $AE_1$ ,  
 (1) the economy is in equilibrium.  
 (2) there is an unintended inventory accumulation and national income will rise.  
 (3) there is an unintended inventory accumulation and national income will fall.  
 (4) there is an unintended inventory reduction and national income will rise.  
 (5) there is an unintended inventory reduction and national income will fall. (.....)
27. According to the Quantity Theory of Money, a 10% increase in the nominal money supply will lead to  
 (1) a 10% increase in the real money supply. (2) an increase in real output of 10%.  
 (3) a 10% decrease in the interest rate. (4) 10% increase in the general price level.  
 (5) an offsetting decrease in the velocity of circulation of money. (.....)
28. Assuming a country's national income is at the full employment level, which one of the following circumstances is most likely to cause inflation?  
 (1) A fall in interest rates (2) A rise in labour productivity  
 (3) An appreciation of the exchange rate (4) A rise in marginal propensity to import  
 (5) An increase in the rates of personal income tax (.....)
29. Commercial banks can create money by  
 (1) converting reserves into securities. (2) buying treasury bills from the Central Bank.  
 (3) sending cash in hand to the Central Bank. (4) maintaining a 100% reserve requirement.  
 (5) lending excess reserves to customers. (.....)
30. Suppose an individual withdraws Rs. 10 000 from his deposit account in a commercial bank. If all else is constant, and the bank has a statutory reserve requirement of 20%, this transaction will directly reduce  
 (1) the money supply by Rs. 10 000. (2) bank deposits by Rs. 10 000.  
 (3) the money supply by Rs. 50 000. (4) bank deposits by Rs. 50 000.  
 (5) bank deposits by Rs. 8 000. (.....)
31. Sri Lankan commercial banks maintain their statutory reserves in the form of  
 (1) cash in hand and deposits at the Central Bank.  
 (2) cash in hand and Treasury Bills.  
 (3) gold and foreign currency in their bank vaults.  
 (4) deposits at other commercial banks that are immediately accessible.  
 (5) deposits and foreign currency at the Central Bank. (.....)

32. If the Central Bank purchases Treasury Bills from a commercial bank, what happens to bank reserves and the money supply?

	Bank reserves	Money supply
(1)	increase	decrease
(2)	increase	increase
(3)	decrease	decrease
(4)	decrease	increase
(5)	increase	no change

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(.....)

33. A good that exhibits neither rivalry nor excludability in consumption cannot be a  
 (1) pure private good. (2) pure public good. (3) inferior good.  
 (4) quasi public good. (5) global public good.

(.....)

34. When a regressive income tax is in operation, the poor pay  
 (1) a lower percentage of their income taxes than the rich.  
 (2) a larger rupee amount in taxes than the rich.  
 (3) a tax that varies proportionately with their income level.  
 (4) a smaller rupee amount in taxes than the rich.  
 (5) a higher percentage of their income in taxes than the rich.

(.....)

35. The marginal social cost of allowing one more individual to use a pure public good is  
 (1) negative. (2) zero. (3) positive.  
 (4) infinite. (5) increasing with the number of users.

(.....)

36. The Table below shows the marginal private and external benefits and the marginal private and external costs of a product produced at a free market equilibrium level of output.

Item	Rs. million	Item	Rs. million
Marginal private benefit	36	Marginal private cost	24
Marginal external benefit	18	Marginal external cost	0

The government intervention in this market could improve the efficiency of allocation of resources because the product is

- (1) a public good. (2) a merit good. (3) a demerit good.  
 (4) a global public good. (5) an inferior good.

(.....)

37. Which of the following methods of financing the budget deficit can increase aggregate demand by the greatest amount?

- (1) Selling bonds to foreigners  
 (2) Selling bonds to the Central Bank  
 (3) Selling bonds to the commercial banks  
 (4) Selling bonds to the National Savings Bank  
 (5) Selling bonds to the Employees Provident Fund

(.....)

38. Consider the following Table.

Year	Export Price Index	Terms of Trade Index
1	100	100
2	90	80
3	80	60

From this data, one possible conclusion that can be drawn over the period shown is

- (1) export prices were rising.  
 (2) import prices were rising.  
 (3) there was an improvement in the terms of trade.  
 (4) more imports could be purchased with the same quantity of exports.  
 (5) increase in export prices was greater than the increase in import prices.

(.....)

[See page seven]

39. Which of the following is correct of a country that does not have an absolute advantage in producing any good or service?
- (1) It cannot have a comparative advantage either.
  - (2) It will have a comparative advantage in the production of the good or service in which it has a lower opportunity cost.
  - (3) It will export raw materials and import finished products.
  - (4) No country will want to trade with this country because it is not cost effective to do so.
  - (5) The international value of its currency will be fixed. (.....)
40. The demand for Sri Lankan rupees in the foreign exchange market is derived from
- (1) exports from Sri Lanka + capital outflows from Sri Lanka.
  - (2) exports from Sri Lanka + capital inflows to Sri Lanka.
  - (3) imports to Sri Lanka + capital outflows from Sri Lanka.
  - (4) imports to Sri Lanka + capital inflows to Sri Lanka.
  - (5) Sri Lanka government's holding of external reserves. (.....)
41. Which of the following statements about comparative advantages is correct?
- (1) Comparative advantage is based solely on differences in climate.
  - (2) Comparative advantage is based solely on differences in factor endowments.
  - (3) To have a comparative advantage, a country must also have an absolute advantage.
  - (4) A country with a rising price level will lose any existing comparative advantage.
  - (5) A comparative advantage for certain products may be created by prudential policies of the government. (.....)
42. Other things being unchanged, an appreciation of the domestic currency
- (1) lowers the domestic price of imported goods.
  - (2) raises the domestic price of imported goods.
  - (3) raises the world price of imported goods.
  - (4) lowers the world price of imported goods.
  - (5) lowers the value of the domestic currency in a foreign country. (.....)
43. Suppose a Sri Lankan Company receives a Rs. 40 million dividend from its garment factory located in the Middle East. How would this transaction be recorded in the Balance of Payments of Sri Lanka on double entry principle?
- (1) A credit in capital account and debit in financial account
  - (2) A debit in capital account and credit in financial account
  - (3) A credit in capital account and debit in current account
  - (4) A credit in current account and debit in financial account
  - (5) A debit in current account and credit in financial account (.....)
44. As some factories become automated, traditional workers find themselves with mismatched skills and some of them become unemployed. At the same time, computer operators are in high demand. This type of unemployment would be classified as
- (1) cyclical unemployment.
  - (2) frictional unemployment.
  - (3) natural unemployment.
  - (4) structural unemployment.
  - (5) disguised unemployment. (.....)
45. Which change would best indicate that a country has achieved development?
- (1) An increase in the country's real GDP
  - (2) An increase in the country's percentage in total world exports
  - (3) An improvement in the balance of payments
  - (4) An appreciation in the country's currency
  - (5) An improvement in the average citizen's quality of life (.....)
46. Total dependency ratio is the ratio of
- (1) children to adults in the population.
  - (2) unemployed to employed population in the labour force.
  - (3) population over 65 years of age to 100 persons in the working-age population.
  - (4) population below 15 years of age to population over 15 years of age.
  - (5) population below 15 years and above 59 years of age to the population aged 15 to 59 years. (.....)

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47. Which of the following data set correctly indicates the sectoral distribution of poverty headcount index in Sri Lanka according to 2012/13 survey data?

	Urban Sector %	Rural Sector %	Estate Sector %
(1)	4.5	10.2	16.3
(2)	2.5	6.7	12.9
(3)	4.2	7.5	10.6
(4)	2.1	7.6	10.9
(5)	3.1	7.9	10.2

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(.....)

48. A Lorenz Curve can be used to evaluate which of the following economic issues?

- (1) The production and allocative efficiency of resources in the economy.
- (2) The comparative advantages of trading partners.
- (3) The intensity of specialization among countries.
- (4) The equality in income distribution.
- (5) The relationship between unemployment and price stability.

(.....)

49. Which of the following correctly indicates the contribution of agricultural sector to Sri Lanka's GDP and employment in 2014?

	GDP %	Employment %
(1)	16.0	28.5
(2)	22.8	32.3
(3)	12.8	45.0
(4)	10.5	26.5
(5)	10.1	28.5

(.....)

50. Which one of the following countries is **not** a member of the G7?

- (1) Japan                      (2) Canada                      (3) France                      (4) Italy                      (5) Russia                      (.....)

\* \* \*



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ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව  
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 ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව  
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 Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka Department of Examinations, Sri Lanka

අධ්‍යයන පොදු සහතික පත්‍ර (උසස් පෙළ) විභාගය, 2016 අගෝස්තු  
 கல்விப் பொதுத் தராதரப் பத்திர (உயர் தர)ப் பரீட்சை, 2016 ஓகஸ்ட்  
 General Certificate of Education (Adv. Level) Examination, August 2016

ආර්ථික විද්‍යාව II  
 பொருளியல் II  
 Economics II

21 E II

පැය තුනයි  
 மூன்று மணித்தியாலம்  
 Three hours

### Instructions:

- \* Answer five questions only, selecting minimum of two questions from Sub-section 'A' and two questions from Sub-section 'B'.
- \* Graph papers will be provided.

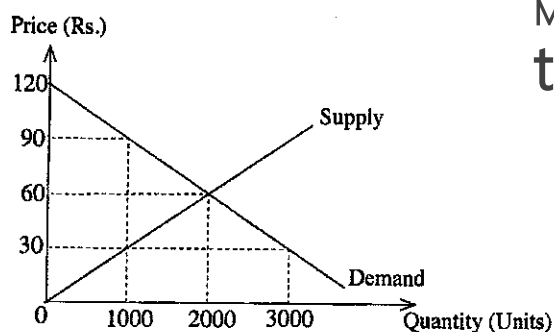
### Sub section 'A'

(Select minimum of two questions from this section.)

- What are the four categories of economic resources? Give an example of a resource for each category. (04 marks)
  - In what ways does a free market economy differ from a centrally-planned economy? (04 marks)
  - Why is money **not** considered to be a capital resource in economics? (04 marks)
  - What is an entrepreneur? Why do entrepreneurs play a key role in a market economy? (04 marks)
  - Why is private property and protection of property rights so critical to the success of the market economy? (04 marks)
- What is production possibilities frontier (PPF)? List the assumptions you make when you draw a production possibilities frontier. (04 marks)
  - What causes production possibilities frontier to shift outward? (02 marks)
  - What does increasing opportunity cost mean? What are the implications of this concept for the shape of the production possibility frontier? (04 marks)
  - Draw a production possibilities frontier for a country facing increasing opportunity costs for producing paddy and textile. Show how the PPF changes given the following events:
    - A new and better fertilizer is invented.
    - There is a surge in the quantity of labour which can be employed in both sectors.
    - A severe drought results in a 10% decrease in usable farmland.
    - A new technology is invented in the textile industry to reduce cost of production. (06 marks)
  - State the difference between productive efficiency and allocative efficiency of resources. (04 marks)
- What factors determine the price elasticity of demand for a consumer good? (04 marks)
  - Why is a downward-sloping linear demand curve more price elastic at higher price ranges and more price inelastic at lower price ranges? (04 marks)
  - Given the income elasticities of demand of the following goods, how would you classify the following goods as 'luxury', 'necessity' and 'inferior' goods?
    - Bottled water 1.3
    - Cowpea -0.8
    - Bread 0.5
    - Mobile Phone 1.8 (04 marks)

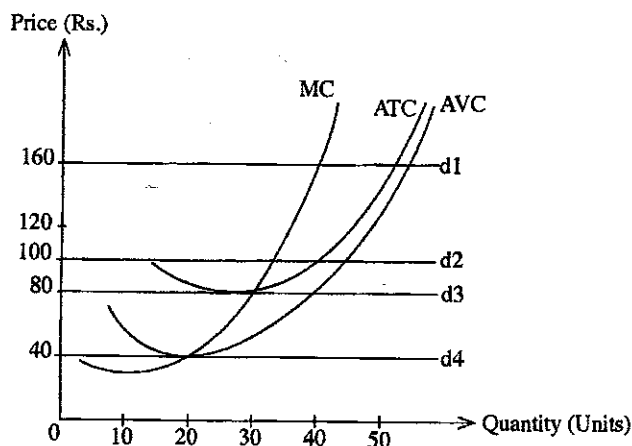
[See page two]

- (iv) The diagram below shows demand and supply curves for a good sold in a competitive market. Assume that the government has now imposed an excise tax of Rs. 60 per unit on producers in this market.



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- (a) By how much will consumer surplus change as a result of the tax? (02 marks)  
 (b) By how much will producer surplus change as a result of the tax? (02 marks)  
 (c) How much revenue will the government collect from the excise tax? (02 marks)  
 (d) Calculate the dead-weight loss created by the tax. (02 marks)
4. (i) What is the difference between diminishing returns and decreasing returns to scale? (04 marks)  
 (ii) Explain the relationship between marginal cost and average total cost. (04 marks)  
 (iii) Explain the concepts, producer surplus, economic profit and economic rent. (04 marks)  
 (iv) Why will a firm in a perfectly competitive industry choose **not** to charge a price either above or below the market price? (04 marks)  
 (v) The following diagram shows demand and cost curves of a firm operating in a perfectly competitive market in the short run.



- (a) Calculate the profit earned by the firm at the market price of Rs. 160. (02 marks)  
 (b) What is the shut down price of the firm? (02 marks)
5. (i) What is value added? How is it calculated? (04 marks)  
 (ii) What are the major components of aggregate income? (04 marks)  
 (iii) Explain whether the following transactions are included or not included in GDP of a country.
- (a) A tourist hotel purchases Rs. 10 million worth of foreign made canned food.  
 (b) A soft drink manufacturing company builds a new bottling plant in the capital city.  
 (c) An investor buys Rs. 30 million worth of shares of a major commercial bank.  
 (d) A book publisher produces too many copies of a new book. The surplus copies that did not sell this year were added to the inventories. (04 marks)

- (iv) The following macroeconomic data are given for an economy: (All figures are in Rs. million)

Autonomous consumption	= 500
Planned investment (I)	= 1 250
Government purchases (G)	= 1 000
Net exports (NX)	= -250
Marginal Propensity to Consume (MPC)	= 0.8

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Determine the equilibrium level of National Income for this economy.

(04 marks)

- (v) The following macroeconomic data are given for an economy. (All figures are in Rs. million)

National Income	= 1 000
Consumption	= 500
Government expenditure	= 250
Net exports	= 100
Budget deficit	= 40

- (a) Calculate disposable national income.

(02 marks)

- (b) What is the value of investment of this economy?

(02 marks)

### Sub section 'B'

(Select minimum of two questions from this section.)

6. (i) What is the difference between the Quantity Theory of Money and the Equation of Exchange? (04 marks)
- (ii) What are the advantages of the National Consumer Price Index over the Colombo Consumer Price Index as a measure of cost of living in Sri Lanka? (04 marks)
- (iii) Why do people hold money? What effect does the level of income have on the amount of money people hold? (04 marks)
- (iv) Assume that for a hypothetical economy, money supply (M) is Rs. 3 600 billion, total bank deposits (D) are Rs. 3 200 billion, the statutory reserve ratio is 10% and the banks do not hold excess reserves.
- (a) What is the value of money multiplier for this economy? (02 marks)
- (b) What should the Central Bank do to decrease money supply by Rs. 100 million in this economy? (02 marks)
- (v) How does the Central Bank of Sri Lanka operate the Standing Rate Corridor (SRC) to control the inter-bank call money market interest rates? (04 marks)
7. (i) Explain how the existence of externalities leads to inefficient allocation of resources in an economy. Illustrate your answer with appropriate diagrams. (04 marks)
- (ii) What are public goods? Why **cannot** markets easily provide such goods? (04 marks)
- (iii) What are the objectives of taxation? (04 marks)
- (iv) Mention the desirable properties of a good tax system. (04 marks)
- (v) List the major components of recurrent expenditure of the government of Sri Lanka. (04 marks)
8. (i) Distinguish between comparative advantage and absolute advantage. (04 marks)
- (ii) Give reasons for the slow growth of earnings from agricultural exports of Sri Lanka in the recent years. (04 marks)
- (iii) Mention the regional and bilateral free trade agreements of Sri Lanka at present. (04 marks)

[See page four]

- (iv) How do you record the following transactions in the Balance of Payments in Sri Lanka using double entry principle?
- A Chinese investor buys stocks worth of \$ 10 million at the Colombo Securities Exchange.
  - A Sri Lankan housemaid working in the Middle East sends \$ 500 to her parents in Sri Lanka.
  - A Sri Lankan bank receives \$ 40 million by selling bonds in foreign financial markets.
  - A Sri Lankan publishing company obtains the copyright of a best selling book in the world for \$ 5 000 from an American publisher to translate and sell it in Sri Lanka. (04 marks)
- (v) Draw an appropriate diagram to show the determination of the external value of Sri Lankan Rupee in terms of US dollars under a floating exchange rate system. Explain why the demand curve is downward sloping and the supply curve is upward sloping in this foreign exchange market. (04 marks)
9. (i) Why it is considered that the Human Development Index (HDI) is a better indicator of development than Gross National Income (GNI) per capita? (05 marks)
- (ii) Mention five different actions the government can take to promote long-term economic growth. (05 marks)
- (iii) What are the important factors that have contributed to reduce the poverty levels in Sri Lanka in the recent years? (05 marks)
- (iv) "Public debt-financed growth strategy based on non-tradable sectors, cannot be expected to lead the economy to long-term sustainable growth." Assess the validity of this statement in the light of the experience of Sri Lanka over the last five years. (05 marks)
10. (i) "The behaviour of foreign direct investment (FDI) in Sri Lanka in the recent years has been disappointing despite numerous fiscal incentives". What are the major obstacles to FDI in Sri Lanka? (05 marks)
- (ii) State the key structural weaknesses of government's fiscal position in Sri Lanka. (05 marks)
- (iii) Give reasons for the widening deficit in the trade balance of Sri Lanka in the recent years. (05 marks)
- (iv) State briefly the current developments in the global economy that can have an adverse impact on the long-term economic growth of Sri Lanka. (05 marks)

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