

Past paper questions 2012 - 2020**Question 7 – Public Economics****Market failure**

1. Which of the following does not indicate market failure? (A/L 2015)
 - 1) Existence of monopolies
 - 2) Excessive air and water pollution
 - 3) A lack of such necessities as national defense
 - 4) The adequate supply of public goods
 - 5) An unequal distribution of income
2. Which one of the following is a reason for government intervention to correct a market failure? (A/L 2012)
 - 1) Inferior goods
 - 2) Diseconomies of scale
 - 3) Externalities in production and consumption
 - 4) Homogeneous products
 - 5) Advertising
3. One reason why free market fails to achieve an optimal allocation of scarce resources is because (A/L 2012)
 - 1) Public goods are provided free of charge to users.
 - 2) Positive externalities lead to overproduction of some goods.
 - 3) There is underproduction of goods with positive externalities.
 - 4) Individual's incomes and wealth are not identical.
 - 5) Existence of competition.
4. What are the obstacles to achieve an efficient allocation of resources in a market economy? (4 marks)(A/L 2013/2019)

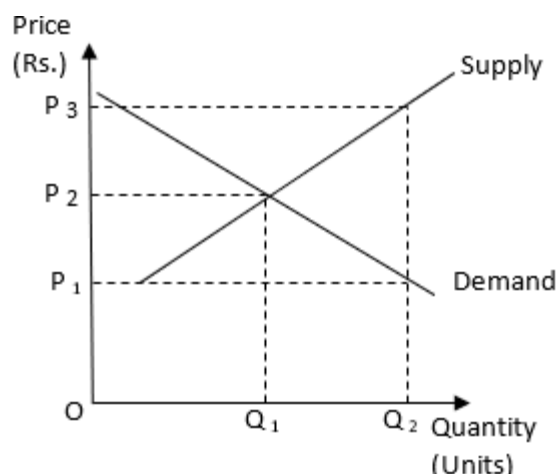
Categories of products

5. An example of a pure public good is (A/L 2017)

1) Health service	3) National defense	5) Education
2) National museum	4) Rail transport service	
6. A pure public good is a good that is (A/L 2015)
 - 1) Provided efficiently by markets.
 - 2) Rivalrous and excludable in consumption.
 - 3) Non-rivalrous and excludable in consumption.
 - 4) Rivalrous and nonexcludable in consumption.
 - 5) Non-rivalrous and nonexcludable in consumption.

7. Market fails to produce public goods because (A/L 2020)
- 1) There is no demand for such goods.
 - 2) It is impossible for the producer to charge a price from the consumers of such product.
 - 3) Such products usually entail large external costs in production and generate external benefits in consumption.
 - 4) Their production leads to increase income inequality.
 - 5) Private firms generally have a higher production cost than the public sector.
8. Public goods are not provided by the market system because, (A/L 2014)
- 1) Even if a cost is incurred in consumption, a profit cannot be earned.
 - 2) A price cannot be charged and non-rivalry in consumption.
 - 3) Those who do not pay price cannot be excluded and non-rivalry in consumption.
 - 4) Even if a profit can be earned, a cost is incurred in consumption.
 - 5) Even if a price can be charged, it cannot be easily implemented.
9. A good that exhibits neither rivalry nor excludability in consumption cannot be a (A/L 2016)
- | | | |
|----------------------|----------------------|-----------------------|
| 1) Pure private good | 3) Inferior good | 5) Global public good |
| 2) Pure public good | 4) Quasi-public good | |
10. A merit good is a good which (A/L 2019)
- 1) Benefits both the recipient and society as well.
 - 2) Does not have a social cost in production.
 - 3) Private benefits of consuming the good exceeds its social benefits.
 - 4) Cannot be supplied through market forces.
 - 5) Can be supplied efficiently through market forces.
11. 'A merit good' is a (A/L 2013)
- 1) Good that is made available to consumers according to merit.
 - 2) Good that the government believes consumers will buy too little of it if it is provided by free market.
 - 3) Good that the government believes consumers will buy too much of it if it is provided by free market.
 - 4) Good where any benefit obtained by one consumer is extended to all consumers.
 - 5) Good where the private benefits of consuming the good exceed its social benefits.

12. The diagram below shows the market demand and supply curves of a merit good. To increase consumption from OQ_1 and OQ_2 , the government could (A/L 2012)



- 1) Tax producers by P_3P_2 per unit of the good
 - 2) Subsidize producers by P_3P_1 per unit of the good
 - 3) Impose a maximum price of OP_3
 - 4) Impose a minimum price of OP_2
 - 5) Introduce a guaranteed price at OP_1
13. Determine whether the following items are private goods, public goods or common resources. (4 marks)(A/L 2018)
- (a) Fish in the ocean
 - (b) Broadcast television signals
 - (c) Basic research on lifestyle and cholesterol levels
 - (d) Specific research on cholesterol lowering drug for which patent can be obtained
14. State whether the following goods and services can be considered as pure public goods. Give reasons for your answer. (3 marks)(A/L 2020)
- (a) Lighthouses
 - (b) Ocean fish
 - (c) The internet
15. Name two merit goods and explain why they are considered as merit goods. (4 marks)(A/L 2020)
16. What are public goods? Why cannot markets easily provide such goods? (4 marks)(A/L 2016)
17. What is a pure public good? How does it differ from a quasi-public good? (4 marks)(A/L 2017)
18. Distinguish between 'pure public goods' and 'merit goods.' (4 marks)(A/L 2015)

19. Define and give an example for each of the following categories of goods and services. (6 marks)(A/L 2012)
- Global public goods
 - Common resources
 - Quasi-public goods
20. Define pure public goods, merit goods, common resources and natural monopolies. (4 marks)(A/L 2019)

Externalities

21. The marginal social cost of allowing one more individual to use a pure public good is (A/L 2016/2019)
- Negative
 - Zero
 - Positive
 - Infinite
 - Increasing with the number of users
22. Which of the following is true of the marginal cost providing a pure public good to one more consumer? (A/L 2018)
- It is positive.
 - It is equal to zero.
 - It is equal to the initial cost of production of the good.
 - It decreases as the number of consumers decrease.
 - It increases as the number of consumers decrease.
23. 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. (A/L 2016)

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.

- A public good
 - A merit good
 - A demerit good
 - A global public good
 - An inferior good
24. The table below indicates the private and external costs and benefits, resulting from building a coal-burning power station. (A/L 2012)

(Rs. Billion)

Private benefits	180
Private costs	190

External benefits	110
External Costs	140

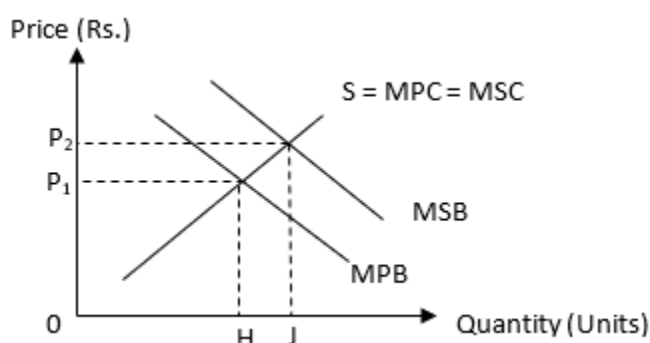
The social cost minus the social benefit equals

- 1) Rs. 120 billion
- 2) Rs. 500 billion
- 3) Rs. 40 billion
- 4) Rs. 30 billion
- 5) Rs. 10 billion

25. Social benefits are higher than the private benefits in (A/L 2014)

- 1) Education and health services
- 2) Infrastructure and environmental conservation activities
- 3) Ports and airport services
- 4) Roads and hospital services
- 5) National parks and environmental conservation activities

26. Given in this diagram are the marginal private benefit (MPB) and marginal social benefit (MSB) curves and the market supply curve (S) for a particular good. (A/L 2017)



In the absence of government intervention in this market, misallocation of resources is likely to occur because of

- 1) The free market price is too high.
- 2) There is overproduction of the good of $H - J$.
- 3) Free market output is too high.
- 4) There is under-consumption of the good of $H - J$.
- 5) Negative externality in consumption.

27. When an externality exists in a free market (A/L 2020)

- 1) The equilibrium price is determined at an artificially high level.
- 2) The equilibrium price is determined at an artificially low level.
- 3) Market cannot reach equilibrium.
- 4) Market equilibrium does not ensure socially optimum resource allocation.
- 5) The consumers of a product incur extra costs in terms of maintenance and insurance.

28. When consumption of a certain good generates a positive externality, which of the following must be true at the market equilibrium? (A/L 2018)
- 1) Marginal social benefit is less than marginal private cost.
 - 2) Marginal social benefit is greater than marginal private benefit.
 - 3) Marginal social cost is greater than marginal social benefit.
 - 4) Marginal social cost is less than marginal private benefit.
 - 5) Marginal social cost is equal to marginal social benefit.
29. If an industry ignores the external costs it generates in its production, which of the following will be true at the competitive market equilibrium output? (A/L 2015)
- 1) Price will be greater than the marginal social cost.
 - 2) Price will be less than the marginal social cost.
 - 3) Price will be equal to the marginal social cost.
 - 4) Marginal private cost will be equal to the marginal social cost.
 - 5) Marginal private cost will be greater than the marginal social cost.
30. When a negative externality exists as a result of a production of a good, the socially optimum quantity of output could be achieved by (A/L 2019)
- 1) Free market equilibrium
 - 2) Subsidizing the production of output
 - 3) Placing limits on the quantity that can be produced
 - 4) Government purchases of the good
 - 5) Setting a minimum on the quantity that can be produced
31. Which consequence of building a new railway line would be classified as a positive externality? (A/L 2013)
- 1) A reduction in road accidents.
 - 2) The increase in profits for the Railways Department.
 - 3) The increase in revenue from tourists traveling on the line.
 - 4) The saving in travel time by passengers who travel on the line.
 - 5) A reduction in the value of real estate located close to the line.
32. Explain using an appropriate diagram, how the market system fails to allocate resources efficiently when the production of goods entails external costs. (5 marks)(A/L 2015)
33. Explain how the existence of externalities leads to inefficient allocation of resources in an economy, illustrate your answer with appropriate diagrams. (4 marks)(A/L 2016)
34. Why does a free market overproduce a good with negative externalities? Explain your answer with an appropriate diagram. (4 marks)(A/L 2017/2020)
35. With the help of an appropriate diagram, explain why there are too many motorists than socially desired in Sri Lanka roads. (4 marks)(A/L 2013)

Government failure

36. Which of the following is most likely to be a reason for what economists call the phenomenon of 'government failure'? (A/L 2018)
- 1) The negative externalities that result from the production of some goods and services
 - 2) Excessive consumption of demerit goods
 - 3) Unequal distribution of income and wealth
 - 4) Imperfect competition in the markets
 - 5) Pursuit of self-interest amongst politicians
37. How do you justify the government interventions in a free market economy? (4 marks)(A/L 2013/2014/2018/2019)

Fiscal policy

38. Fiscal policy involves the government determining (A/L 2015)
- 1) Market interest rates
 - 2) The money supply growth rate
 - 3) Taxation and government spending levels
 - 4) The money supply
 - 5) The rate of inflation
39. An appropriate fiscal policy to combat a recession would be an increase of (A/L 2018)
- 1) Interest rates
 - 2) Money supply
 - 3) Taxes
 - 4) Sale of government bonds
 - 5) Government spending
40. If the economy is in severe recession, which of the following is the fiscal policy most effective in stimulating production? (A/L 2012)
- 1) Government spending increases.
 - 2) Government spending decreases.
 - 3) Personal income taxes are increased.
 - 4) The Central Bank sells securities on the open market.
 - 5) The Central Bank buys securities on the open market.
41. The supply-side policy measures that promote production are (A/L 2014)
- 1) Production subsidies, deregulation, tax reforms and nationalization
 - 2) Tax reforms, nationalization, and deregulation, removal of rigidities in labour and capital markets

- 3) Regulation, tax reforms, expansion of administrative and development activities and labour and capital market reforms
- 4) Production subsidies, expansion of administrative and development activities, deregulation and trade restrictions
- 5) Tax reforms, privatization, deregulation and labour and capital market reforms

42. Explain the ways in which fiscal policy can reduce income inequality. (4 marks)(A/L 2013)

Government revenue

43. The prominent source of revenue of the central government of Sri Lanka at present is (A/L 2020)

- 1) Taxes on income
- 2) Taxes on production and expenditure
- 3) Profits, dividends and interest
- 4) Gross receipts of trading enterprises
- 5) Lottery revenues

44. At present, the single largest tax revenue source of the government of Sri Lanka is (A/L 2015)

- 1) Value added tax
- 2) Corporate income tax
- 3) Excise tax
- 4) Import duty
- 5) Pay As You Earn (PAYE) tax

45. The principal sources of tax revenue in Sri Lanka are (A/L 2018)

- 1) Income Tax, Value Added Tax and Excise Duties
- 2) Value Added Tax, Turnover Tax and Economic Service Charge
- 3) Income Tax, Value Added Tax and Stamp Duty
- 4) Value Added Tax, Import Duties and Nation Building Tax
- 5) Value Added Tax, Port and Airport Levy and Economic Service Charge

46. A regressive income tax is one where the poor (A/L 2020)

- 1) Have a lower percentage of their income taxed than the rich.
- 2) Pay a larger rupee amount in taxes than the rich.
- 3) Pay a tax that varies proportionally with their income.
- 4) Have a higher percentage of their income taxed than the rich.
- 5) Are able to use tax revenue to purchase essential goods.

47. When a regressive income tax is in operation, the poor pay (A/L 2016)

- 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.
48. A regressive tax is defined as one where (A/L 2013)
- 1) All tax payers pay the same absolute amount of their income in taxation.
 - 2) High income earners pay a lower proportion of their income in taxes than low income earners.
 - 3) High income earners pay less in taxes than low income earners.
 - 4) High income earners pay more in taxes than low income earners.
 - 5) The tax burden can be shifted backward.
49. What are the objectives of taxation? (4 marks)(A/L 2016)
50. Outline the desirable properties of good tax system. (4 marks)(A/L 2013/2016)
51. Explain why taxes are necessary for a country and briefly outline the desirable properties of a good tax. (4 marks)(A/L 2019)
52. Distinguish between vertical equity and horizontal equity of taxation. (4 marks)(A/L 2018)
53. What are the major sources of excise tax revenue in Sri Lanka? (4 marks)(A/L 2017)
54. Define proportional tax, progressive tax and regressive tax. (3 marks)(A/L 2015)
55. Distinguish between statutory tax incidence and economic tax incidence. (4 marks)(A/L 2012)
56. What is meant by 'neutrality of taxation'? (2 marks)(A/L 2012)
57. What are the non-tax revenue sources of the government of Sri Lanka in the recent years? (4 marks)(A/L 2012/2020)

Government expenditure

58. The government revenue to GDP ratio and the government expenditure to GDP ratio in Sri Lanka in recent years were approximately, (A/L 2017)

	Revenue /GDP Ratio (%)	Expenditure/GDP Ratio (%)
1)	15 - 16	25 - 26
2)	12 - 13	24 - 25
3)	13 - 14	20 - 21
4)	10 - 11	15 - 16
5)	15 - 16	18 - 19

59. The main components of the recurrent expenditure of Sri Lanka are (A/L 2020)
- 1) Interest payments, acquisition of real assets, salaries and wages and transfers to households.
 - 2) Interest payments, salaries and wages, capital transfers to public corporations and pensions.
 - 3) Interest payments, salaries and wages, current transfers to households and current transfers to public corporations.
 - 4) Interest payments, salaries and wages, amortization payments and current transfers to households.
 - 5) Interest payments, salaries and wages, acquisition of financial assets and fertilizer subsidy.
60. According to their relative importance in total expenditure, the main components of recurrent expenditure of Sri Lankan government can be ranked as (A/L 2017)
- 1) Transfers to households, interest payments, salaries and wages.
 - 2) Salaries and wages, interest payments, transfers to households.
 - 3) Transfers to public institutions, interest payments, salaries and wages.
 - 4) Transfers to households, salaries and wages, interest payment.
 - 5) Interest payments, transfers to public institutions, transfers to households.
61. The biggest component of government recurrent expenditure in Sri Lanka at present is (A/L 2019)
- 1) Interest payments
 - 2) Salaries and wages
 - 3) Pension payments
 - 4) Fertilizer subsidy
 - 5) Current transfers to public corporations
62. Classify government expenditure according to the economic classification. (5 marks)(A/L 2014)
63. List the major components of recurrent expenditure of the government of Sri Lanka. (4 marks)(A/L 2016)

Government budget

64. The widely used credit instrument in domestic financing budget deficit of Sri Lanka in recent years has been (A/L 2017)
- 1) Treasury Bills
 - 2) Treasury Bonds
 - 3) Rupee Securities
 - 4) Sri Lanka Development Bonds
 - 5) Central Bank Advances
65. Which of the following methods of financing the budget deficit can increase aggregate demand by the greatest amount? (A/L 2016)
- 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
66. Primary account balance of the government budget is defined as the difference between (A/L 2019)
- 1) Tax revenue and capital expenditure
 - 2) Total revenue including grants and total expenditure excluding interest payments on debt
 - 3) Total revenue and total expenditure including repayment of debt
 - 4) Tax revenue and recurrent expenditure
 - 5) Total revenue and recurrent expenditure
67. Distinguish between 'appropriation bill' and 'vote on account'. (4 marks)(A/L 2020)
68. What are the main sources of financing the budget deficit of Sri Lanka in the recent past? (5 marks)(A/L 2014)
69. Distinguish between 'primary deficit' and 'net cash deficit' of the budget. (4 marks)(A/L 2012)
70. What is meant by the 'primary balance' of the government budget? Why is it considered to be important to have a surplus in the primary balance? (4 marks)(A/L 2019)
71. Why do some economists argue that budget deficits contribute to increased market rates of interest and reduced private investment? (4 marks)(A/L 2018)
72. "Sri Lanka's public finances are at a perilous state" (Institute of Policy Studies). Identify the major weaknesses in public finances in Sri Lanka at present. (4 marks)(A/L 2017)
73. State briefly the important measures taken by the government of Sri Lanka in recent years to address the critical issues in public finances. (4 marks)(A/L 2017)

Public debt

74. "Public debt of Sri Lanka as a percentage of Gross Domestic Product shows a declining trend in recent years." The main reason for this is, (A/L 2014)
- 1) The decrease in public debt while Gross Domestic Product remains constant
 - 2) The decrease in public debt and increase in Gross Domestic Product.
 - 3) The decrease in both public debt and Gross Domestic Product.
 - 4) The increase in Gross Domestic Product while public debt remains constant.
 - 5) The increase in Gross Domestic Product is higher than the increase in public debt.

75. “The government debt-to-GDP ratio in Sri Lanka still remains very high when compared to other countries in the region.” Outline briefly the measures taken by the government of Sri Lanka to ensure sustainable debt level in the medium and long term. (4 marks)(A/L 2018)
76. Describe briefly the recent trends of the public debt rate in Sri Lanka. (5 marks)(A/L 2014)
77. “Sri Lanka’s public debt appears even more worrisome when compared to the government revenue.” Explain this statement. (3 marks)(A/L 2015)