

Time 2 hours
Instructions Answer 5 questions only.

1.
 - i. Represent the following situations which are related to the Sri Lankan economy using a PPC with increasing opportunity cost.
 - a) Re opening of warmer high security Zone fishing areas for fishermen. (02 Marks)
 - b) Donation of trollar machines by the Indian government to uplift the fishing industry in Sri Lanka. (02 Marks)
 - c) Unemployment in the economy (02 Marks)
 - d) Reduction in space available to harvest after a natural disaster. (2 marks)
 - ii. "A static economy (operating on the PPC) without any growth will be able to increase production of a particular product only by scarifying production of another product. But a growing economy will be able to increase production without any sacrifice. "Do you agree? Explain using relevant diagrams. (4 marks)
 - iii. What can you say about a PPC which is convex to the origin? Comment on the nature of resources used in this scenario. (04 marks)
 - iv. 'Free goods can not be depicted in a production possibility diagram' do you agree with this statement? Comment. (04 Marks)

2.

i. What are the main determinants of supply? And what factors are held constant when moving along the supply curve? (4 marks)

ii. In a particular market demand and supply equations have been given as follows:

$$Q_d = 200 - 10p$$

$$Q_s = 300 + 10p$$

Can this market arrive at market equilibrium? Explain. (04 marks)

iii. Using appropriate diagrams explain following situations.

- a. As a result of a change in both demand and supply curves equilibrium quantity has increased but equilibrium price remains unchanged. (01 Mark)
- b. As a result of a change in both demand and supply curves equilibrium quantity has decreased but equilibrium price remains unchanged. (01 Mark)
- c. As a result of a change in both demand and supply curves equilibrium price has increased but equilibrium quantity remains unchanged. (01 Mark)
- d. As a result of a change in both demand and supply curves equilibrium price has decreased but equilibrium quantity remains unchanged. (01 Mark)

iv. Explain the law of supply and mention why the supply curve slopes upwards. (02 marks)

v. 'When a market arrives to its allocative efficiency, it satisfies 3 conditions'. What are those conditions? (02 Marks)

vi. In a competitive market when there is an equilibrium exchange, economic surplus of that market reaches its maximum. Explain this statement. (04 marks)

3.

- i. 'In oligopoly market, in order to restrict entry both natural and artificial barriers are used'.

Briefly explain main entry barriers used in oligopoly market (04 Marks)

- ii. Information about a certain firm which operates in a perfectly competitive market within the short-run period is given from the diagram below.

a) At which output level will this firm's short-run average product and marginal product be the same? Explain the reason for your answer. (1 mark)

b) At which price level will this firm make "Normal Profits?" Explain the reason for your answer. (1 mark)

c) At which output level is this firm's marginal product being maximized? Explain the reason for your answer. 1 mark)

- iii. Perfect competitive firm achieves 'economic efficiency' in the long run. Do you agree? Explain your answer. (04 marks)

- iv. Why do we make the following conclusions about a firm in perfect competition?

A. the firm is a price taker (2 marks)

B. The average revenue and the marginal revenue of the firm are equal (2 marks)

C. The firm can earn only normal profits in the long run (2 marks)

- v. Using an appropriate diagram explain how perfectly competitive market arrive at the market equilibrium in the short run? (03 Marks)

4.

- i. Even though some of the production activities are related to the production of new goods they are still excluded from national accounts. Do you agree with this statement? Explain your answer with examples. (03 marks)
- ii. Explain why an economy's total output in essence is also its total income (03 Marks)
- iii. Why are interest payments by the government considered part of personal income but not part of national income? (04 Marks)
- iv. What are the reasons for fluctuations in GDP in the short run? Explain (2 marks)
- v. The following macroeconomic data are given for an economy. (All figures are in Rs. Million)

National Income	=	5 000
Consumption	=	2500
Government Expenditure	=	1250
Net exports	=	500
Budget deficit	=	200

- (a). Calculate disposable national income.(02 marks)
 - (b). What is the value of investment of this economy?(02 marks)
- vi. Graphically show the two conditions that should be fulfilled in macroeconomic equilibrium of an open economy. (4 marks)

5.

- i. What do you mean by policy interest rates of the Central Bank of Sri Lanka? (02 marks)

What is headline inflation? What are the factors that affect headline inflation?(4 marks)

- ii. What factors could cause the actual expansion of the money supply to differ from that given by the deposit expansion multiplier? (3 marks)
- iii. Distinguish between quantitative and qualitative credit control methods of the Central Bank of Sri Lanka. (3 marks)
- iv. "When the policy makers are unable to identify the natural rate of unemployment accurately, it will lead to stagflation." Do you agree? Explain.(3 marks)
- v. The following is a simplified balance sheet for one of the banks in a commercial banking system in a country.

Liabilities	Value (Rs. Million)	Assets	Value (Rs. Million)
Deposits	120 000	Required reserves	18 000
Shareholders' equity	20 000	Excess reserves	5 000
		Securities	32 000
		Loans	85 000
Total Liabilities	140 000	Total assets	140 000

- a) What is the required reserve ratio? (1 mark)
- b) Assume that a customer withdraws Rs. 5 000 million from his current account at this bank. By how much will this bank's reserve change based on this cash withdrawal? (2 marks)
- c) Assuming that the required reserve ratio remains unchanged, what is the maximum amount of new loans that this bank could make after the withdrawal of Rs. 5 000 million deposits? (2 marks)

6.

- i. Name 4 policies that can be used to control inflation. (2 marks)
- ii. What is producer price index and what are the key importance of producer price index (03 marks)
- iii. Increase in the use of electronic money will challenge the efficiency of the monetary policy? Do you agree? Explain. (3 marks)
- iv. “Nominal interest rates are always positive” Do you think that real interest rates are also positive? (03 marks)
- v. What are the reasons for differences between interest rates? Explain. (04 Marks)
- vi. A hypothetical balance sheet of a commercial banking system is given below:

Liabilities (Rs. Million)		Assets (Rs. Million)	
Demand Deposits	2,000	Reserves	400
		Loans	1600
Total	2,000	Total	2,000

Further, the currency held by public in this economy is Rs. 1,200 million and there is an excess reserve of Rs. 200 million in the banking system.

- a) Calculate the maximum possible amount of total money supply in this economy when the full credit creation is completed. (03 marks)
- b) If the legal reserve ratio increases to 25% and the currency held by the public remains unchanged, calculate the maximum possible amount of total money supply when full credit creates is completed. (02 marks)

7.

- i. Explain the difference between deflation and disinflation. (02 marks)
- ii. Distinguish between money market and capital market (3 marks)
- iii. What are the 2 concepts presented in order to highlight the primary causes related to cost- push inflation? Explain (4 marks)
- iv. What are the factors those should be considered when converting other financial assets into perfect liquid asset? (2 marks)
- v. What are the key roles performed by the Central Bank of Sri Lanka in establishing financial system stability? (05 marks)
- vi. What are the factors that can limit credit creation? (4 marks)