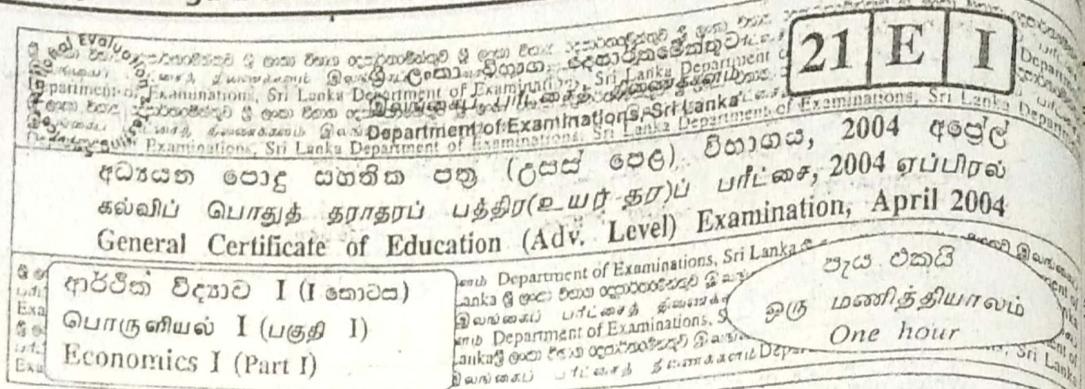


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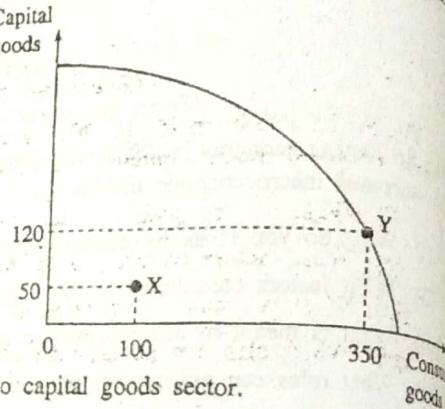
Index No. :

- Note:**
- * There are 20 questions in this Part and all questions are compulsory.
 - * Each question carries 02 marks and the total marks for this Part is 40.
 - * Each multiple-choice question has only one correct answer. Identify and underline the correct answer.
 - * All questions in Part I must be answered on this paper itself.
 - * After answering both Part I and Part II, tie the two sets of answer scripts together and hand them over to the Supervisor.

1. The following diagram represents the production possibility curve for an economy producing capital and consumer goods.

If the economy represented in the diagram shifted its level of production from point X to point Y, there would be

- an opportunity cost of 70 units of capital goods.
- an opportunity cost of 250 units of consumer goods.
- an increase in unemployment.
- no opportunity cost involved.
- a transfer of resources from consumer goods sector to capital goods sector.



2. A mixed economy may be defined as one in which resources are

- allocated to meet the needs of both consumers and producers.
- used partly for the production of consumer goods and partly for the production of capital goods.
- allocated partly by market forces and partly by the state.
- allocated purely by the spending decisions of entrepreneurs.
- allocated purely by the spending decisions of consumers.

3. Which of the following is not held constant when a consumer demand curve is drawn up?
- | | |
|--|---|
| (i) The price of the good under consideration. | (ii) The price of complementary goods |
| (iii) The price of substitutes. | (iv) The price of factors of production |
| (v) The consumer income. | |

4. Market failure is

- a situation where demand does not equal supply.
- a situation in which a market does not allocate resources efficiently.
- caused by firms leaving an industry.
- only associated with centrally planned economies.
- the result of a government setting a price above the free market equilibrium.

What effect will the falling computer prices have on the software market?

- (i) Increase in demand
- (ii) Increase in supply
- (iii) Decrease in demand
- (iv) Decrease in supply
- (v) Increase in quantity demanded

If a tax is imposed on a market with elastic demand and inelastic supply,

- (i) buyers will bear most of the burden of the tax.
- (ii) buyers alone will bear the burden of the tax.
- (iii) sellers will bear most of the burden of the tax.
- (iv) the burden of the tax will be shared equally between buyers and sellers.
- (v) it is impossible to determine how the burden of the tax will be shared.

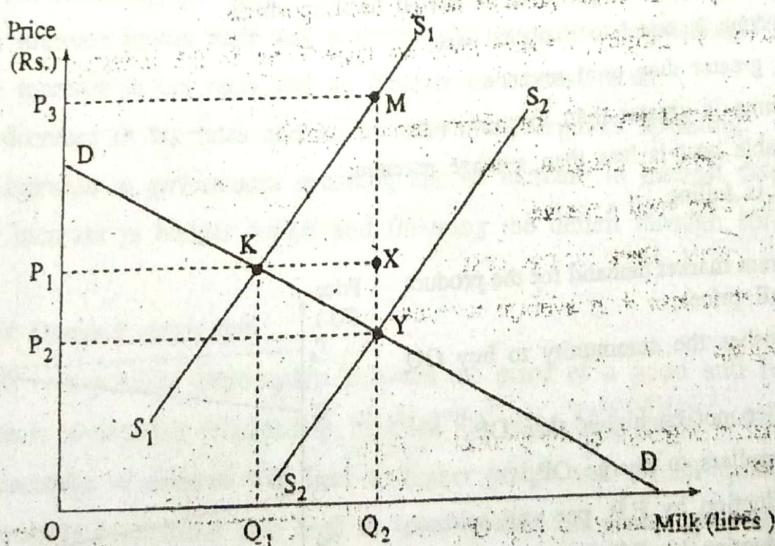
If a given change in the price of a good results in no change in total revenue,

- (i) the demand for the good must be elastic.
- (ii) the demand for the good must be inelastic.
- (iii) buyers must not respond very much to a change in price.
- (iv) the demand for the good must be unit elastic.
- (v) the demand for the good must be zero elastic.

Which one of the following factors is likely to cause the price of rice to increase without a shift in the demand curve?

- (i) An increase in the productivity of paddy farmers
- (ii) An increase in real incomes of consumers
- (iii) An increase in the wages of agricultural workers
- (iv) An increase in the fertilizer subsidy for paddy cultivation
- (v) An increase in the total population whose staple food is rice

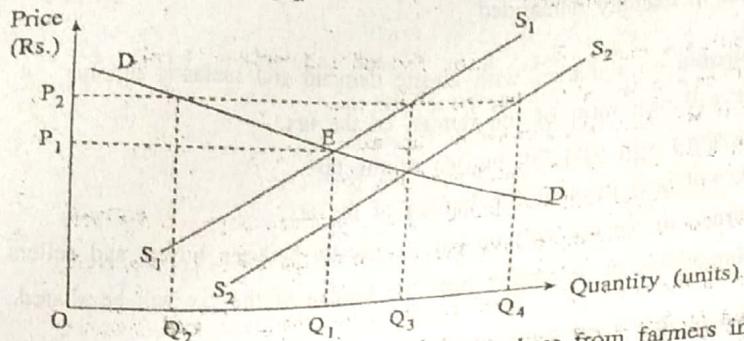
Assume that the government announces a subsidy to support milk production in Sri Lanka as shown in the diagram below.



Which of the following would represent the cost of the subsidy to the government?

- (i) $P_2 P_3 M Y$
- (ii) $O P_2 Y Q_2$
- (iii) $O P_1 X Q_2$
- (iv) $O P_3 M Q_2$
- (v) $P_1 P_3 M X$

10. As shown in the diagram below, the market for paddy is currently in equilibrium at E where S_1S_1 is the supply of paddy and DD is the demand for paddy. In year 1 the government announces a minimum guaranteed price of OP_2 at which it will buy up any surplus paddy production. In year 2 paddy production increases, shown by the shift in the supply curve to S_2S_2 .



What is the quantity of paddy that the government will have to purchase from farmers in year 2?

- (i) From Q_3 to Q_4
- (ii) From Q_2 to Q_3
- (iii) From Q_2 to Q_4
- (iv) From Q_1 to Q_3
- (v) From Q_1 to Q_4

11. If the quantity demanded of good A increases when incomes are decreasing, then:
- (i) good A is a complement.
 - (ii) good A is a substitute.
 - (iii) good A is a normal good.
 - (iv) good A is an inferior good.
 - (v) good A is an inelastic good.

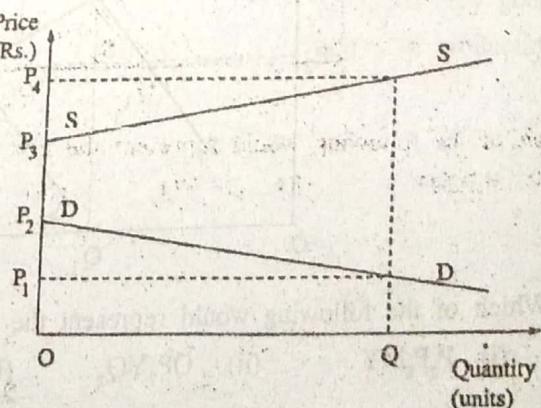
12. In perfect competition, the elasticity of demand faced by a single firm is
- (i) zero, because the firm produces a unique product.
 - (ii) zero, because many other firms produce homogeneous products.
 - (iii) infinity, because the firm produces a unique product.
 - (iv) infinity, because many other firms produce homogeneous products.
 - (v) varied between zero and infinity, because there are many firms in the industry.

13. A firm will always earn abnormal profit at an output level at which
- (i) marginal revenue is equal to marginal cost.
 - (ii) total cost is greater than total revenue.
 - (iii) average revenue is greater than average cost.
 - (iv) average variable cost is less than average revenue.
 - (v) average cost is falling.

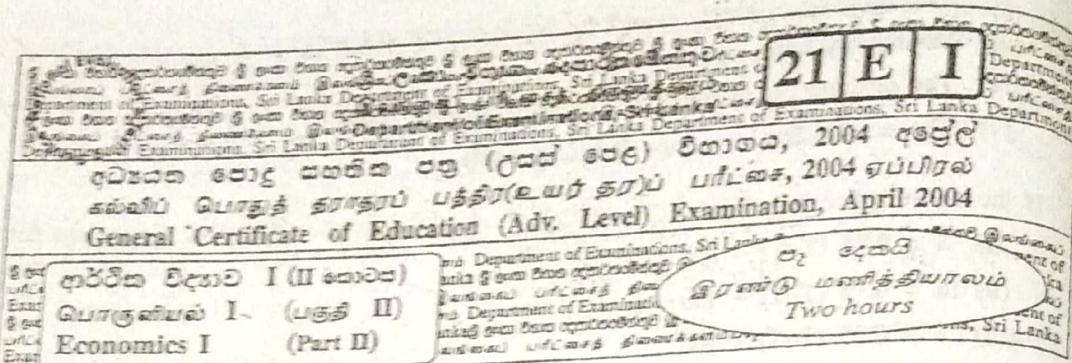
14. In the following diagram market demand for the product is below supply at all prices.

If the government wishes the community to buy OQ units, it will have to

- (i) direct that price not be higher than OP_1 .
- (ii) permit the suppliers to charge OP_4 .
- (iii) subsidise production by P_2P_3 per unit sold.
- (iv) subsidise production by P_1P_3 per unit sold.
- (v) subsidise production by P_1P_4 per unit sold.



15. Which one of the following will be included in ~~net~~ investment in an economic sense?
- Government expenditure on pharmaceutical products.
 - The purchase of shares issued by public limited companies.
 - Savings by consumers in NSB.
 - The replacement of obsolete equipment by new machines.
 - The construction of a new industrial estate.
16. If the consumption function is: $C = 0.75(Y-T) + 100$ when $T = 50$, then the savings function is:
- $S = 0.75(Y-T) - 100$
 - $S = 0.75(Y-T) + 150$
 - $S = 0.25(Y-T) - 100$
 - $S = 0.25(Y-T) + 175$
 - $S = -0.25(Y-T) + 100$
17. Which one of the following is not true?
- $Y = C + I + G + X - M$
 - $I + G + X = S + T + M$
 - $Y = C + I + G + NX$ (NX = Net Exports)
 - $Y + M = C + I + G + X$
 - $Y = C + S + T$
18. A pure public good is essentially one
- which is provided exclusively by the public sector at prices below opportunity cost.
 - which is provided exclusively by the private sector at prices below market price.
 - which is provided by both the private and public sectors at a price below market price.
 - the consumption of which does not deny its consumption by others.
 - the production of which involves no opportunity cost.
19. Which of the following indicates a contractionary fiscal policy?
- An increase in tax rates and a decrease in government spending.
 - An increase in tax rates and an increase in interest rates.
 - A decrease in tax rates and an increase in government spending.
 - A decrease in government spending and an increase in interest rates.
 - An increase in budget deficit and financing the deficit through foreign borrowing.
20. The Law of Demand states that
- there is a positive relationship between the price of a good and its quantity demanded.
 - there is a negative relationship between the price of a good and its quantity demanded.
 - an increase in demand will lead to higher prices and greater quantities.
 - a decrease in demand will lead to lower prices and lesser quantities.
 - both (iii) and (iv) given above are correct.



Instructions: Answer four questions only selecting two questions from Sub-section A and two questions from Sub-section B.

Sub-section A

1. Assume that a country producing a combination of automobiles and computers is at a point on the production possibilities curve with increasing opportunity cost. Draw separate diagrams representing automobiles in the horizontal axis and computers in the vertical axis to show how the following events affect the production possibilities curve. Give an explanatory note on each of your diagrams.

 - There is a substantial net out-migration of skilled computer workers. (03 marks)
 - There is a decrease in the productivity of computer workers, but no change in employment within either industry. (03 marks)
 - Technological progress causes some workers in the automobile industry to become unemployed, but this has no effect on the computer industry. (03 marks)
 - There is a decrease in the demand for automobiles causing unemployment in that sector but no change in the demand for computers. (03 marks)
 - The demand for computers increases and the demand for automobiles decreases, but there is no change in employment within either industry. (03 marks)

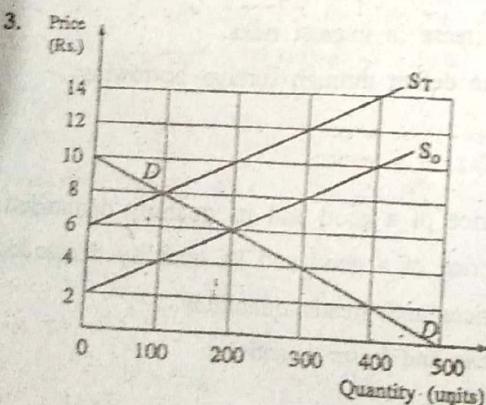
2.

 - What are the functions of price in a market economy? (03 marks)
 - Outline the advantages and disadvantages of a planned economy. (04 marks)
 - What justification would you advance for government intervention in a free market economy? (04 marks)
 - Explain how economic profit differs from accounting profit. (04 marks)

Answer the following questions using the graph below that shows the effect of a unit tax on producers.

| Quantity (units) | Price (Rs.) - D | Price (Rs.) - D' | Supply Curve (S_o) | Supply Curve (S_T) |
|------------------|-----------------|------------------|--------------------|--------------------|
| 0 | 10 | 8 | 2 | 2 |
| 100 | 9 | 7 | 3 | 3 |
| 200 | 8 | 6 | 4 | 4 |
| 300 | 7 | 5 | 5 | 5 |
| 400 | 6 | 4 | 6 | 8 |
| 500 | 5 | - | 7 | - |

 - What is the equilibrium price and quantity before the tax and after the tax? (02 marks)
 - What is the amount of total tax borne by the consumers? (02 marks)
 - What is the total tax revenue collected after the tax is implemented? (03 marks)
 - What is the producer surplus when the market is in equilibrium before the tax? After the tax? (04 marks)
 - What is the consumer surplus when the market is in equilibrium before the tax? After the tax? (04 marks)



Answer the following questions using the graph below that shows the effect of a unit tax on producers.

- (i) What is the equilibrium price and quantity before the tax and after the tax? (02 marks)

(ii) What is the amount of total tax borne by the consumers? (02 marks)

(iii) What is the total tax revenue collected after the tax is implemented? (03 marks)

(iv) What is the producer surplus when the market is in equilibrium before the tax? After the tax? (04 marks)

the market is in equilibrium before the tax? (04 marks)

4. A market researcher obtains the following information about the demand for good X.
- If the price of good X increases by 25%, 5% fewer units of good X are sold.
 - If consumer income increases by 4%, 8% more units of good X are sold.
 - If the price of good Y increases by 1%, 5% fewer units of good X are sold.

Based on each of the possible events described above, answer the questions below:

- What is the income elasticity of good X? (03 marks)
- What is the price elasticity of good X? (03 marks)
- What is the cross-price elasticity of good X in relation to good Y? (03 marks)
- Is good X a complement or a substitute for good Y? (03 marks)
- Is the demand for good X elastic or inelastic? (03 marks)

Sub-section B

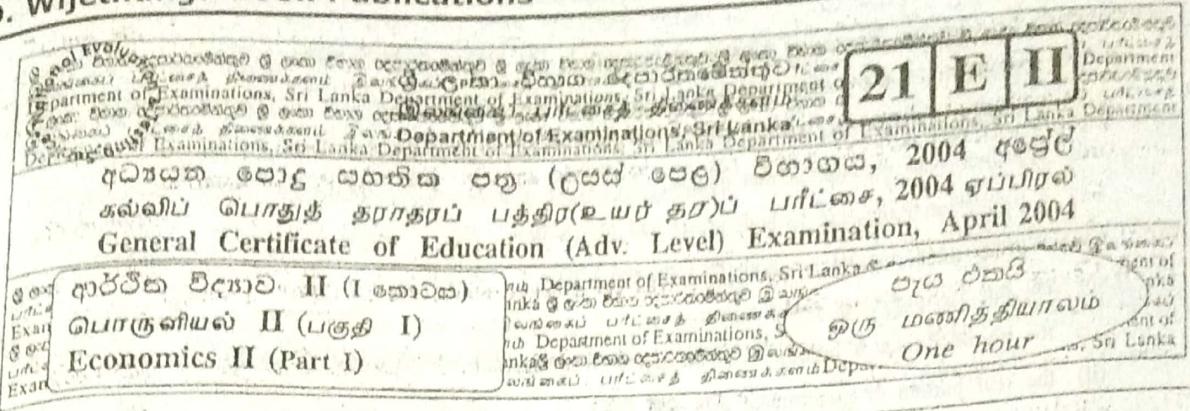
(Select two questions from this Section.)

5. You have been given the following national income accounting data of an economy for a given year : (figures in Rs. billions).

| | |
|---------------------------------|-----|
| Personal consumption | 450 |
| Compensation of employees | 375 |
| Exports | 120 |
| Net foreign factor income | 30 |
| Government purchases | 60 |
| Gross investment | 100 |
| Imports | 160 |
| Net Indirect business taxes | 15 |
| Net interest | 60 |
| Profits | 70 |
| Rent income | 40 |
| Transfer payments to households | 5 |
| Personal taxes | 20 |

- Calculate (a) GNP (b) GDP (c) NDP (d) NI and (e) DPI. (02 marks each)
- What is the amount of depreciation pertaining to the given year? (02 marks)
- List major items of government transfer payments to households in Sri Lanka. (03 marks)
- Why is the sum of the marginal propensity to consume and the marginal propensity to save always equal to one? (03 marks)
- What productive activities are not measured and thus not included in GDP? (04 marks)
- Explain what is meant by "injections" and "withdrawals" from the circular flow of income in an open economy. (04 marks)
- Calculate the first four rounds of the multiplier effect for an increase of Rs. 100 billion in investment spending for a closed economy without a government sector where the MPC is 0.8. (04 marks)

7. (i) What is meant by externalities? (04 marks)
- (ii) Distinguish between private costs and social costs. (04 marks)
- (iii) Give two examples of economic activities with positive externalities. (02 marks)
- (iv) Using an appropriate diagram, explain the difference between free market level of output and socially efficient level of output for an economic activity which generates external benefits. (05 marks)
8. "The overall fiscal deficit during the last ten years was on average about 9% of GDP". (Annual Report 2002, Central Bank of Sri Lanka).
- (i) What are the principal causes for the large budget deficits in Sri Lanka since 1990? (05 marks)
- (ii) Examine the economic costs of large budget deficits. (05 marks)
- (iii) Outline the major measures taken by the government to restore fiscal discipline in Sri Lanka in recent years. (05 marks)



Index No. :

Note: * There are 20 questions in this Part and all questions are compulsory.

Each question carries 02 marks and the total marks for this Part is 40.

* Each question carries 02 marks and the total marks for this section is 10.
* Each multiple-choice question has only one correct answer. Identify and underline the correct answer.

*All questions in Part I must be answered on this paper itself.

* After answering both Part I and Part II, tie the two sets of answer scripts together and hand over to the Supervisor.

1. An asset (other than money) is considered to be most liquid if
 - (i) it has a long maturity.
 - (ii) it is issued by a major company rather than the government.
 - (iii) it earns a high rate of interest.
 - (iv) it has more than one use.
 - (v) it can be, quickly and with least cost, transferred into money.
 2. Assume that a commercial bank has total deposits of Rs. 250 million and Rs. 170 million of total reserves. The remainder of the bank assets are loans. If the required reserve ratio is 10%, then what is the amount of excess reserves currently held by this bank?
 - (i) Rs. 800 million
 - (ii) Rs. 145 million
 - (iii) Rs. 128 million
 - (iv) Rs. 25 million
 - (v) Rs. 17 million

Which of the following policy actions taken by the Central Bank is likely to increase the money supply?

- (i) selling government bonds
 - (ii) reducing reserve requirements
 - (iii) increasing the discount rate
 - (iv) all of the above
 - (v) none of the above

4. According to Quantity Theory of Money, an increase in the money supply causes
(i) a proportional increase in prices.
(ii) a proportional increase in the velocity of money.
(iii) a proportional increase in real output.
(iv) a proportional increase in both prices and real output.
(v) a proportional increase in both velocity and prices.
5. If the real rate of interest is positive then,
(i) the nominal rate of interest must be greater than the rate of inflation.
(ii) the real burden of government debt will fall.
(iii) the nominal rate of interest must be less than the rate of inflation.
(iv) the real value of personal savings will fall.
(v) the rate of inflation is likely to rise.
6. Sustained high inflation affects economic growth because,
(i) the resulting high prices induce more investment across the economy, leading to an increase in the rate of growth.
(ii) it encourages more borrowing, which improves economic growth.
(iii) it improves investors' confidence which improves economic growth.
(iv) it increases uncertainty about future returns which reduces economic growth.
(v) it encourages more investment in assets like real estate and gold which appreciate equally or at a higher rate than the rate of inflation.
7. Suppose the employed population is 40 million, the number of unemployed is 10 million, the working age population is 70 million and the number of persons who are not willing to work is 20 million, the unemployment rate is,
(i) 25.0% (ii) 20.0% (iii) 16.7% (iv) 14.3% (v) 11.1%
8. Which of the following could cause economic growth?
(i) increase in net out-migration (ii) increase in factor productivity
(iii) increase in transfer payments (iv) increase in interest rates
(v) increase in money supply
9. Which of the following is a possible cause of cost-push inflation?
(i) Increased demand for the country's exports.
(ii) Increased trade union militancy resulting in wage increases.
(iii) Increased bank lending.
(iv) An increased public sector borrowing.
(v) An increased balance of payments surplus.
10. Price stability occurs when
(i) all prices in the economy are constant.
(ii) the rate of inflation is zero.
(iii) the rate of inflation is constant.
(iv) the general price level increases at a steady rate.
(v) real per capita income level remains constant.

11. In the context of international trade, the term 'dumping' refers to
- exporting inferior quality products to developing countries by developed countries.
 - acquiring comparative advantage in waste disposal.
 - exporting at a price below average cost.
 - pollution of international waters outside legal restrictions.
 - destruction of surplus output.
12. Given the price elasticity of demand for exports at -0.7 and the price elasticity of demand for imports at -0.8 , then the depreciation in the external value of currency is likely to lead to
- an increase in the volume of imports.
 - a decrease in the volume of exports.
 - an improvement in the terms of trade.
 - a deterioration in the current account of the Balance of Payments.
 - an improvement in the current account of the Balance of Payments.
13. If over a given period, export prices rose by 20% but the terms of trade deteriorated by 25%, then import prices must have risen by
- 16%
 - 20%
 - 25%
 - 40%
 - 60%
14. When foreign owned companies operating in Sri Lanka use profits from their Sri Lankan operations to pay dividends to their shareholders overseas, the transaction is recorded in Sri Lanka's Balance of Payments on
- net current transfers account in the current account.
 - net income account in the current account.
 - net service account in the current account.
 - capital transfers account in the capital and financial account.
 - direct investment abroad account in the capital and financial account.
15. A major objective of the World Trade Organization is to
- provide short term loans for countries with balance of payments difficulties.
 - provide financial help and advice to developing countries.
 - reduce the general level of protection in world trade.
 - achieve an orderly pattern in world currency exchange rates.
 - increase the general level of protection in world trade.
16. Which of the following conditions will generally lead to a fall in a country's real per capita income?
- A high rate of population growth accompanied by an even higher rate of growth of the capital stock.
 - A high rate of population growth and a stagnant capital stock.
 - A high rate of growth in the capital stock and a rapid rate of technological change.
 - A low rate of population growth and a high rate of technological change.
 - A low rate of population growth and a growing capital stock.

17. Which of the following factors causes a decrease in the dependency ratio of a country?
- A fall in the number of employed persons
 - An increase in the number of persons in the potential labour force
 - An increase in the number of births
 - A decrease in the number of persons unemployed
 - An increase in the number of old-aged persons
18. Which of the following statements is false?
- Economic development is measured by a wide range of indicators such as life expectancy and education
 - Economic growth means a sustained increase in the output of goods and services of a country
 - Standard of living is measured using indices such as per capita income and per capita consumption of electricity and energy.
 - When the economy grows then all the people in a country have a better standard of living.
 - A rising population and a constant national income in real terms means that on average people become poorer.
19. The percentage shares of employment in agriculture, industry and services sectors in Sri Lanka in year 2002 were respectively,
- 48%, 24%, and 28%
 - 20%, 25%, and 55%
 - 24%, 32%, and 44%
 - 33%, 21%, and 46%
 - 31%, 29%, and 40%
20. Identify the group of top five countries in terms of Human Development Index from the lists given below:
- Norway, Belgium, Sweden, Finland and Luxembourg
 - Norway, Iceland, Sweden, Australia and Netherlands
 - Norway, Japan, United States of America, Canada and Switzerland
 - Norway, Canada, Japan, Finland and Sweden
 - Norway, Australia, Ireland, Netherlands and Belgium

අධ්‍යාපන මාරු සහතික රැඳු (රුධ්‍ය පෙල) විගණක, 2004 අප්‍රේල් කෘෂික පොතුත තරගතරුප පත්තිරූපය තරුප පරිශ්‍රී, 2004 අප්‍රේල් General Certificate of Education (Adv. Level) Examination, April 2004

ආර්ථික ජිද්‍යාව II (II සංස්කීර්ණ)

பொருளியல் II (பகுதி II) Economics II (Part II)

Department of Examinations, Sri Lanka
Department of Examinations, Sri Lanka
Department of Examinations, Sri Lanka
Two hours

Instructions: Answer four questions selecting two questions from sub-section A and two questions from sub-section B.

Sub-section A

(Select two questions from this Section.)

- (i) What are the objectives of the Central Bank of Sri Lanka according to the Monetary Law Act as amended in 2002? (02 marks)

(ii) Distinguish between money, near money and money substitutes. (03 marks)

(iii) What is the difference between monetary base and money supply? (04 marks)

(iv) Why do people demand money? Explain. (06 marks)

(i) Outline the main types of financial intermediaries operating in Sri Lanka. (04 marks)

| Liabilities | | Assets | |
|----------------------|---------|---------------|---------|
| Demand Deposits | 200 000 | Reserves | 50 000 |
| Shareholders' Equity | 50 000 | Securities | 55 000 |
| | | Loans | 145 000 |
| | 250 000 | | 250 000 |

Does the bank have any excess reserves? If so, how much? (02 marks)

- (iii) What is the maximum loan that this bank could extend? (02 marks)

(iv) Indicate how the bank's balance sheet would be altered if it extended this loan. (03 marks)

(v) If the required reserve ratio were 20 percent, would the bank be in a position to extend any additional loans? Explain. (04 marks)

- (i) "Trading blocks are becoming increasingly important in the world economy." List the benefits that a member country could obtain by joining a trading block. (03 marks)

(ii) Using appropriate data examine the major changes that have taken place in Sri Lanka's export structure since 1977. (04 marks)

(iii) "The competitiveness of Sri Lanka's manufacturing sector has declined in recent years". Outline the factors which might have affected the decline in international competitiveness of Sri Lankan goods. (04 marks)

(iv) What measures could be taken to increase Sri Lanka's international competitiveness? (04 marks)

4. (i) What is meant by real exchange rate? (02 marks)
- (ii) What can cause a change in the real exchange rate that will lead to an increase in a country's net exports? (04 marks)
- (iii) Outline the arguments against floating exchange rates. (04 marks)
- (iv) Describe the likely effects of a depreciation of the external value of the Sri Lankan rupee on the Sri Lankan economy. (05 marks)
- Sub-section B**
(Select two questions from this Section.)
5. (i) What is meant by 'social capital'? (03 marks)
- (ii) "High levels of savings are a necessary but not a sufficient precondition for economic growth." Do you agree? Give reasons. (04 marks)
- (iii) To what extent can a government in a developing country influence the rate of growth? (04 marks)
- (iv) What is the difference between growth and development? (04 marks)
6. (i) How is labour force participation rate (activity rate) measured in Sri Lanka? (03 marks)
- (ii) Give reasons for the existing high level of unemployment among educated youth in Sri Lanka. (03 marks)
- (iii) What measures could you propose to increase labour productivity in Sri Lanka? (04 marks)
- (iv) Outline the measures taken by the government in recent years to improve flexibility in the labour market. (05 marks)
7. (i) Distinguish between the concepts of absolute poverty and relative poverty. (04 marks)
- (ii) Outline the factors which account for poor people in developing countries deriving little benefit from economic growth. (05 marks)
- (iii) What are the main weaknesses of the Samurdhi programme as a strategy of poverty alleviation in Sri Lanka. (06 marks)
8. (i) What is meant by structural adjustment policies? (04 marks)
- (ii) What are the repercussions of such policies on economic growth and human development. (05 marks)
- (iii) "In June 2002, the Sri Lankan government submitted a Poverty Reduction Strategy Paper (PRSP) to the IMF and World Bank at a donors' Development Forum in Colombo". Outline any three major structural reforms proposed by the Sri Lankan government in this strategy paper. (06 marks)