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General Certificate of Education (Advanced Level) Examination, April 2003

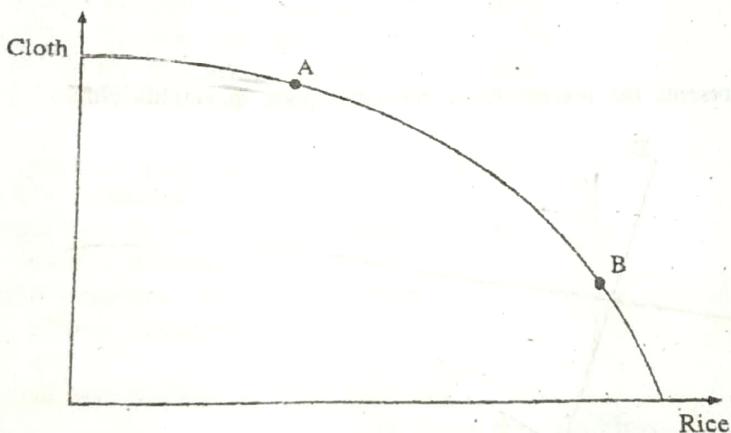
அரசின் தீர்மான I (இணைப்பு) பொருளியல் I (பகுதி I) Economics I (Part I)

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 over to the Supervisor.

- The following diagram shows a production possibility curve defined over cloth and rice.



If the economy changes its production from point A to B, which of the following statements about the opportunity cost of cloth and rice is correct?

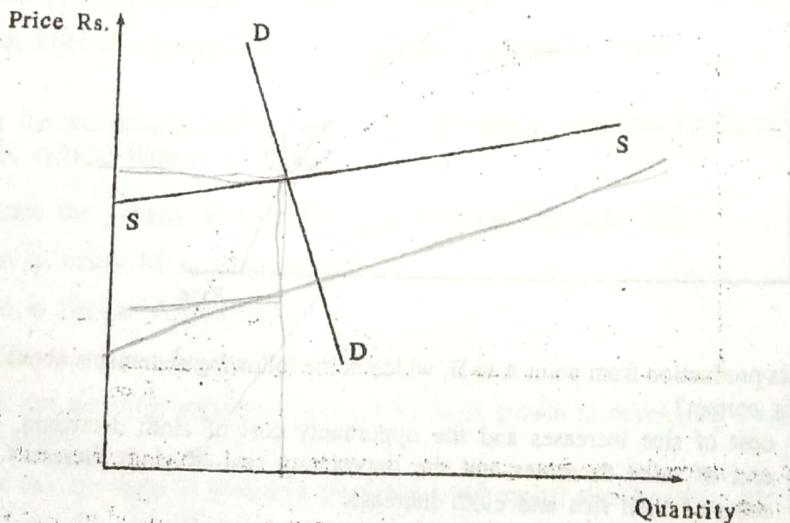
- (i) The opportunity cost of rice increases and the opportunity cost of cloth decreases.
 - (ii) The opportunity cost of rice decreases and the opportunity cost of cloth increases.
 - (iii) The opportunity costs of both rice and cloth increase.
 - (iv) The opportunity costs of both rice and cloth decrease.
 - (v) The opportunity cost of rice increases while that of cloth is left unchanged.

What is an economic good?

- (i) A good which is sold at a profit
 - (ii) A good which is produced under conditions of increasing efficiency
 - (iii) A good which can be supplied only by the private sector
 - (iv) A good which has an opportunity cost
 - (v) A good which can be supplied only by the public sector

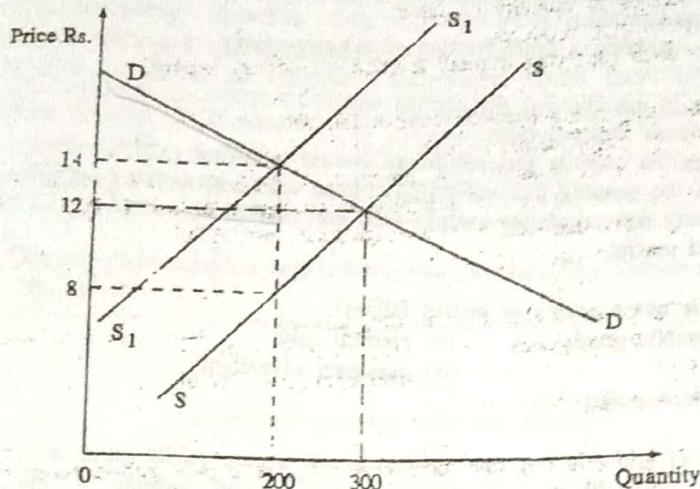
3. The economic problem of "what shall be produced" in a planned economy is determined
- by the independent decisions of the entrepreneurs.
 - by joint directions of the consumers and the government.
 - partly by market forces and partly by the state.
 - by the directives of the government.
 - by the spending decisions of the consumers.
4. The demand curve for a normal good will shift to the left if
- the income of consumers rise.
 - the price of the good rises.
 - the prices of complementary goods rise.
 - advertising expenditure on complementary goods increase.
 - there is an increase in preference for the commodity.
5. The market demand function for coconut is, $Q_d = 300 - 6P$.
 The supply function for coconut is, $Q_s = 20 + 8P$.
 If the price of a coconut is set at Rs. 15, the coconut market will experience,
- equilibrium.
 - excess demand causing a rise in price.
 - excess demand causing a fall in price.
 - excess supply causing a rise in price.
 - excess supply causing a fall in price.
6. A decrease in the price of X from Rs. 50 to Rs. 30 causes an increase in the demand for Y from 100 to 1200 units. What is the cross elasticity of demand between X and Y?
- 0.5
 - 0.5
 - 2.0
 - 2.0
 - 2.5

7. The diagram below represents the market for a consumer good in equilibrium.



- A government decision to subsidise the producers of this good will benefit
- consumers only.
 - producers only.
 - consumers and producers equally.
 - consumers more than producers.
 - producers more than consumers.

8. The following diagram shows that when the government imposes a specific indirect tax on the production of a commodity, the market supply curve shifts from SS to S_1S_1 .



What will be the incidence of the tax on consumers and producers?

- (i) Consumers bear Rs. 1200 and producers bear Rs. 400
 - (ii) Consumers bear Rs. 800 and producers bear Rs. 1200
 - (iii) Consumers bear Rs. 400 and producers bear Rs. 1200
 - (iv) Consumers bear Rs. 800 and producers bear Rs. 400
 - (v) Consumers bear Rs. 400 and producers bear Rs. 800
9. If demand for a product is price inelastic, total revenue will
- (i) fall if price is increased.
 - (ii) increase regardless of the direction of price change.
 - (iii) increase if price is reduced.
 - (iv) be unchanged regardless of the price change.
 - (v) increase if price is increased.
10. If a firm's fixed costs are doubled, marginal cost will
- | | |
|------------------------------|------------------------------|
| (i) double. | (ii) more than double. |
| (iii) remain unchanged. | (iv) increase by 50 percent. |
| (v) decrease by 100 percent. | |
11. Normal profit is defined as the rate of profit
- (i) for a firm over a period of years.
 - (ii) for an industry over a period of years.
 - (iii) required to keep resources in their present usage.
 - (iv) required to keep the firm in a state of equilibrium.
 - (v) earned by producing at the point where marginal cost equals marginal revenue.
12. A perfectly competitive firm is maximizing profit if
- (i) marginal cost equals price and price is above minimum average variable cost.
 - (ii) marginal cost equals price and price is above minimum average fixed cost.
 - (iii) total revenue is at a maximum.
 - (iv) average variable cost is at a minimum.
 - (v) average total cost is at a minimum.

13. Which of the following is not a characteristic of a perfectly competitive industry?
- downward-sloping industry demand curve.
 - perfectly elastic demand curve for each individual firm
 - each firm decides its quantity of output.
 - slightly differentiated products
 - many firms each supplying a small fraction of industry supply.
14. In the long run, the firm in monopolistic competition will
- face a perfectly elastic demand curve.
 - produce more than the quantity that minimises average total cost (ATC).
 - produce less than the quantity that minimises average total cost (ATC).
 - produce the quantity that minimises average total cost (ATC).
 - earn super normal profits.
15. Which of the following is not a source of market failure?
- the existence of public goods
 - external costs
 - external benefits
 - consumer sovereignty
 - the existence of monopolies
16. The marginal social cost of allowing one more person to use a pure public good is
- negative.
 - zero.
 - positive.
 - infinite.
 - double.
17. Which of the following is included in a given year's GDP?
- The purchase of 1000 shares of a company.
 - The payment of 2% of the value of shares made by the buyer to the brokerage firm involved in the stock transaction.
 - A monthly pension payment received by a retired government servant.
 - A monthly scholarship allowance received by a university student.
 - Interest payments made by the government on Treasury Bills.
18. For a given economy, assume that
- | | | |
|---------------------|---|--------|
| exports | = | 300; |
| imports | = | 400; |
| taxes | = | 1 100; |
| government spending | = | 1 400; |
| saving | = | 900. |
- What is the level of investment in this economy?
- 600
 - 700
 - 900
 - 1 100
 - 1 300
19. Assume a simple macroeconomic model with no government and no foreign sector. If savings function is defined as $S = -300 + 0.1 Y$ and investment increases by 200, by how much will consumption increase?
- 180
 - 200
 - 1,800
 - 2,000
 - 2,100
20. "One of the main fiscal issues in Sri Lanka at present is the low revenue/GDP ratio." What was the revenue/GDP ratio of Sri Lanka in the Year 2001?
- 19.0%
 - 17.7%
 - 18.5%
 - 16.0%
 - 16.5%



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

Section A

(Select two questions from this Section.)

- (i) What is meant by 'scarcity', and why does the existence of scarcity make choices unavoidable?
- (ii) How does the production possibility frontier illustrate scarcity? Explain your answer with a diagram.
- (iii) What does the concave shape of the production possibility frontier indicate about resources and opportunity costs? (05 marks for a part)

- (i) Outline the main characteristics of a free market economy. (03 marks)
- (ii) State the ways in which the price mechanism allocates resources in a free market economy. (03 marks)
- (iii) Outline the methods by which a government in a mixed economy could deal with the problems of income inequality. (04 marks)
- (iv) What are the main disadvantages of the price mechanism as a means of allocating resources. (05 marks)

- P e D*
- (i) What are the major determinants of price elasticity of demand? (03 marks)
 - (ii) What type of goods have (a) positive price elasticity of demand, (b) negative cross elasticity of demand and (c) income elasticity of demand greater than one? (03 marks)
 - (iii) How do you define the income and substitution effects of a fall in the price of a product? (04 marks)
 - (iv) State whether total revenue will increase, decrease or remain unchanged when:
 - (a) price falls and demand is inelastic.
 - (b) price rises and demand is elastic.
 - (c) price rises and demand is inelastic.
 - (d) price falls and demand is elastic
 - (e) price falls and demand is of unit elasticity.
(05 marks)

- (i) With the help of a diagram illustrate 'producer surplus'. (03 marks)
- (ii) Explain any two similarities and any two differences between perfect competition and monopolistic competition. (04 marks)
- (iii) What is the difference, if any, between 'diminishing returns' and 'decreasing returns to scale'? (04 marks)
- (iv) Under what circumstances does the total earnings of a factor of production contain transfer earnings? Explain your answer using a diagram. (04 marks)

Section B

(Select two questions from this section.)

5. You are given the following national income accounting data of an economy:

Item	Amount (in Rs. Millions)
Private consumption expenditure	45 000
Public consumption expenditure	15 000
Gross investment	20 000
Change in inventories	500
Net exports	- 5 000
Imports	16 000
Net factor incomes from abroad	- 2 000
Net transfers from abroad	5 000

Compute the following:

- (i) Gross National Product (04 marks)
- (ii) Disposable Gross National Product (03 marks)
- (iii) National Savings (04 marks)
- (iv) Current account balance of the Balance of Payments (04 marks)

6. (i) "There are two ways of expressing the national income equilibrium for an open economy." (02 marks)
State them with usual notations.
- (ii) Consider a macroeconomy characterised by the following equations:

(values are in Rs. millions)

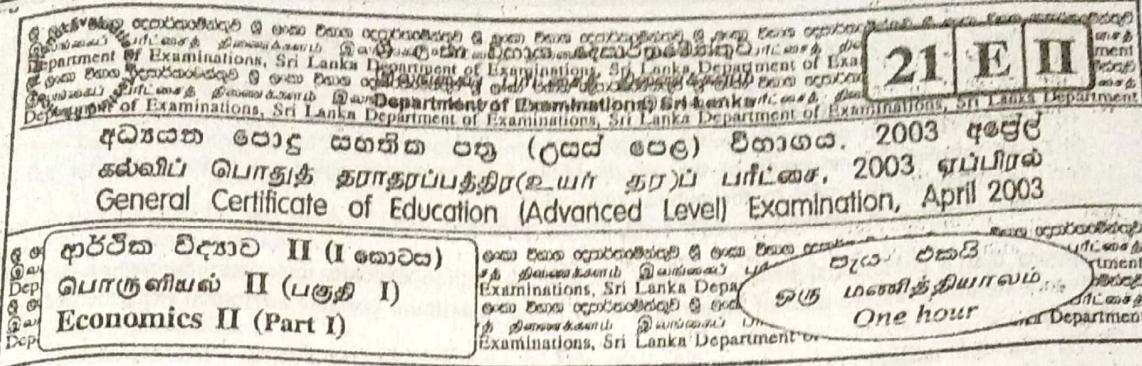
$$\begin{aligned} C &= 200 + 0.9 Yd \\ I &= 80 \\ G &= 300 \\ T &= 120 \end{aligned}$$

where C = consumption, I = investment, G = government spending, and T = taxes.
Using this information answer the following:

- (a) Calculate the equilibrium level of national income. (05 marks)
- (b) What happens to the equilibrium level of national income if investment rises by Rs. 20 million? (04 marks)
- (c) If the full employment level of national income is to be Rs. 5000 million, by how much should investment increase in the economy to reach that level? (04 marks)

7. (i) Outline the main economic functions of the government. (03 marks)
- (ii) What is a pure public good? (03 marks)
- (iii) What is meant by 'state failure'? (03 marks)
- (iv) "In most countries the role of the state in the economy has been reduced in recent years." Outline the factors that contributed to this trend. (04 marks) (05 marks)

8. (i) "The losses from major state-owned enterprises in Sri Lanka have become very large in recent years." Give three reasons that are responsible for their poor performance. (03 marks)
- (ii) Indicate two expansionary and two non-expansionary methods of financing a budget deficit. (04 marks)
- (iii) Name four important reforms proposed for restructuring public enterprises in Sri Lanka. (04 marks)
- (iv) State two arguments for and two arguments against privatisation of state-owned enterprises. (04 marks) (04 marks)



Index No. :

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

1. Which one of the following is not considered part of M_4 ?
 - (i) Currency held by the Central Bank.
 - (ii) Demand deposits held by public at commercial banks.
 - (iii) Fixed deposits held by public at finance companies.
 - (iv) Savings deposits held by public at the National Savings Bank.
 - (v) Savings deposits held by public in Non-Resident Foreign Currency accounts.

2. Which of the following is not a function of money?

(i) Medium of exchange.	(ii) Unit of account.
(iii) Shelter against inflation.	(iv) Store of value.
(v) Standard of deferred payments.	

3. Which one of the following is most liquid?

(i) Demand deposits.	(ii) Real estate.
(iii) Savings deposits.	(iv) Treasury bills.
(v) Bills of Exchange.	

Which one of the following would lead to a contraction in money supply?

- (i) A depreciation in the exchange rate.
- (ii) An increase in personal income tax.
- (iii) Central Bank encouraging commercial banks to increase loans.
- (iv) Central Bank selling government securities.
- (v) Central Bank buying government securities.

Interest rates will be an effective instrument of monetary policy, if

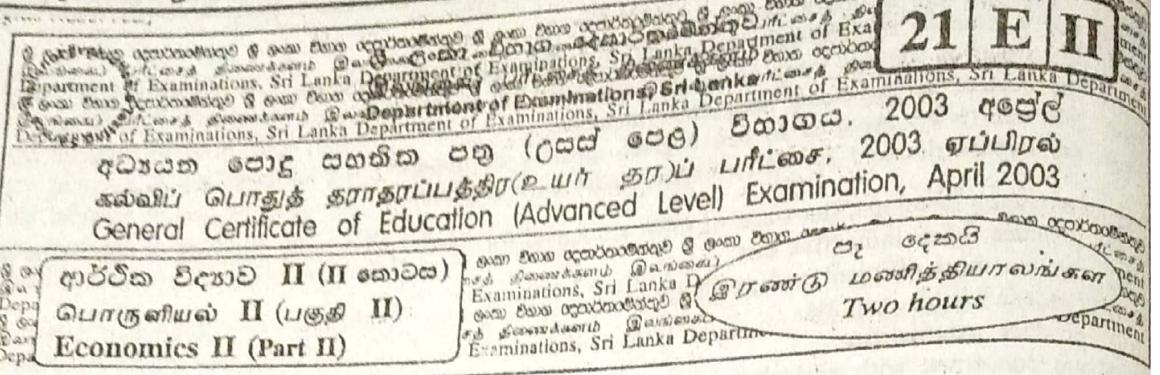
- (i) an increase in interest rates raises the cost of government borrowing.
- (ii) the demand for bank loans is interest elastic.
- (iii) the demand for bank loans is interest inelastic.
- (iv) the supply of money is interest elastic.
- (v) the supply of money is interest inelastic.

6. The broad money supply (M_2) in Sri Lanka increased by nearly Rs. 84 billion in 2001. The major factor that contributed to this increase was
 (i) the increase in net foreign assets.
 (ii) the increase in net credit to the government.
 (iii) the increase in net credit to the private sector.
 (iv) the increase in credit to the public corporations.
 (v) the increase in demand deposits held by the public.
7. Suppose that a commercial banking system has Rs. 50 million deposits and cash reserves of Rs. 6 million. Given a statutory reserve ratio of 10 percent, what is the maximum possible additional expansion of the money supply?
 (i) Rs. 0.5 million
 (ii) Rs. 1 million
 (iii) Rs. 10 million
 (iv) Rs. 11 million
 (v) Rs. 60 million
8. Which one of the following must essentially occur during inflation?
 (i) An increase in budget deficit.
 (ii) An increase in the price of imported raw materials.
 (iii) A redistribution of income from debtors to creditors.
 (iv) A reduction in nominal interest rate.
 (v) A fall in the value of country's money.
9. Which one of the following would be suggested by a fall in the GNP deflator?
 (i) The standard of living has necessarily risen.
 (ii) The external value of rupee has fallen against other currencies.
 (iii) All prices must have fallen.
 (iv) The purchasing power of money must have risen.
 (v) The real income must have decreased.
10. The output of rice and sugar resulting from a given quantity of factor inputs in two countries X and Y is as follows:
- | | | | |
|------------|------------------|----|-------------------|
| Country X: | 18 units of rice | or | 6 units of sugar |
| Country Y: | 9 units of rice | or | 3 units of sugar. |
- From this information it can be deduced that
 (i) Y cannot benefit from trade because X is more efficient in producing both goods.
 (ii) X cannot benefit from trade because Y's unit costs of production are lower for both goods.
 (iii) neither country can benefit from trade because their opportunity cost ratios are the same.
 (iv) both countries can benefit from trade because each has a comparative advantage in one commodity.
 (v) both countries can benefit from trade because of the differences in their absolute costs.
11. Which of the following is a credit item on the current account of the Sri Lanka Balance of Payments?
 (i) Sri Lanka imports cement from Indonesia.
 (ii) The purchase of Sri Lanka Telecom shares by foreign investors.
 (iii) The overseas earnings of Sri Lankan garment manufacturers.
 (iv) Interest payment by Sri Lanka on a loan given by the World Bank.
 (v) New direct investment by a Canadian firm on port development in Sri Lanka.
12. Devaluation of a country's currency would necessarily result in a fall in the
 (i) budget deficit.
 (ii) interest rates.
 (iii) terms of trade.
 (iv) balance of payments surplus.
 (v) external assets.

Year	National Income at Current Prices (1990 = 100)	Population (1990 = 100)	General Price Level (1990 = 100)
1995	200	200	150
2000	210	220	200

Which one of the following best describes the changes that took place between 1995 and 2000?

- (i) Real national income had risen.
 - (ii) Money national income per head had risen.
 - (iii) Real national income per head had fallen.
 - (iv) The standard of living had risen.
 - (v) Income distribution became more even.



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

Section A

(Select two questions from this section.)

1.
 - (i) Distinguish between money market and capital market. (02 marks)
 - (ii) What is the difference between 'near money' and 'money substitutes'? (04 marks)
 - (iii) What is meant by the term 'base money' (high-powered money)? (04 marks)
 - (iv) Suppose that the statutory reserve ratio is 15% and that the bank has cash reserves of Rs. 30 million, loans and investments of Rs. 170 million, and demand deposits of Rs. 200 million.
 - (a) Assume that this bank operates within a banking system. Can this bank expand its loans? Give reasons for your answer. (03 marks)
 - (b) What will be the increase or decrease in the quantum of bank lending if reserve ratio is reduced to 10%? (02 marks)
2.
 - (i) "Nominal interest rates are always positive." Do you think that real interest rates are also positive? (02 marks)
 - (ii) What is the main difference between treasury bills and treasury bonds? (02 marks)
 - (iii) What is Central Bank Repurchase (Repo) market and why is it important? (05 marks)
 - (iv) What methods does the Central Bank use for reducing the money supply? (06 marks)
3. You are given the following data on the balance of payments of a country:

Exports of goods	4 800
Balance of trade	- 1 100
Services (net)	100
Income (net)	- 280
Current transfers (net)	950
Capital account (net)	200
Financial account (net)	400
Long-term financial account (net)	450

(All figures are in Rs. millions)

- On the basis of these data estimate the following:
- (i) Value of imports
 - (ii) Current account balance
 - (iii) Overall balance (03 marks)
 - (iv) Short-term financial account balance (03 marks)
 - (v) Monetary movements (04 marks)

- (i) Assume that both United States and Japan produce two goods, computers and bicycles. The number of labour units needed to produce these goods are shown in the table below:

Labour Cost of Producing Computers and Bicycles (labour hours per unit of output)		
Commodity	United States	Japan
Computer	100	120
Bicycle	5	8

- (a) Which one of these countries has an absolute advantage in the production of both commodities? (02 marks)
- (b) Estimate the opportunity cost of computers in terms of bicycles and of bicycles in terms of computers for each of the countries. (04 marks)
- (c) Which country has a comparative advantage in the production of computers? (02 marks)
- (ii) What are the various ways in which countries seek to protect their industries against foreign imports? (04 marks)
- (iii) Distinguish between depreciation and devaluation of exchange rate. (03 marks)

Section B

(Select two questions from this section.)

"The Sri Lankan economy in 2001 was characterised by a negative real growth, increased inflation and worsened macroeconomic imbalances."

- (i) What do you mean by negative real growth? (02 marks)
- (ii) What factors contributed to the negative real growth in Sri Lanka in 2001? (04 marks)
- (iii) What is meant by macroeconomic imbalances? (04 marks)
- (iv) What roles can government play in promoting economic growth? (05 marks)

"In spite of the enormous efforts put into poverty alleviation during the 1990s, poverty incidence in Sri Lanka showed little or no change."

- (i) Indicate the poverty levels of Sri Lanka between 1990 and 1995. (04 marks)
- (ii) What is meant by a 'poverty line'? (05 marks)
- (iii) What is Human Poverty Index? (06 marks)
- (i) What are the most important factors that inhibit growth in developing countries including Sri Lanka? (05 marks)
- (ii) What can be done to overcome the problem of capital shortage? (05 marks)
- (iii) What factors are responsible for underutilization of foreign aid in Sri Lanka? (05 marks)
- (i) What is meant by the expectation of life at birth? (02 marks)
- (ii) Name development indicators that use life expectancy as one of the components. (02 marks)
- (iii) "Expectation of life at birth in Sri Lanka is relatively high." Do you agree? Give reasons. (05 marks)
- (iv) What measures would you suggest to improve the expectation of life at birth in Sri Lanka? (06 marks)