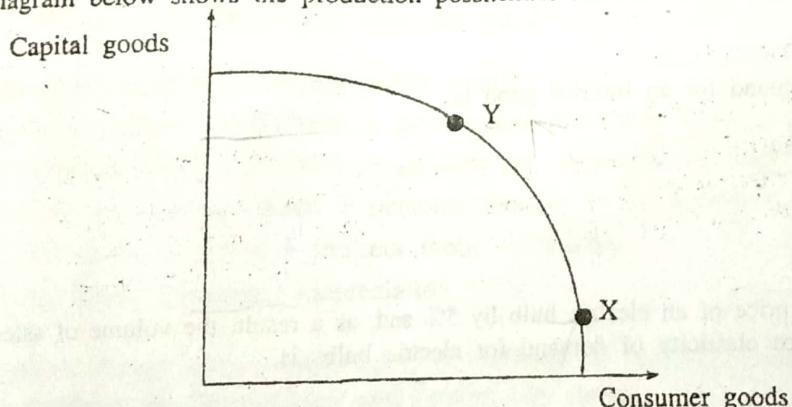


Index No. :

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1. The fundamental economic problem faced by all countries is,
  - (i) too much money chasing after few goods.
  - (ii) excessive use of earth's scarce resources.
  - (iii) environmental pollution.
  - (iv) unlimited wants constrained by limited resources.
  - (v) growing poverty.
2. Which of the following is a scarce resource?
  - (i) Coal
  - (ii) Water
  - (iii) Skilled labour
  - (iv) Time
  - (v) All of the above
3. The diagram below shows the production possibilities frontier of an economy.



Indicate the correct combination of current and future living standards resulting from a movement from X to Y on the curve?

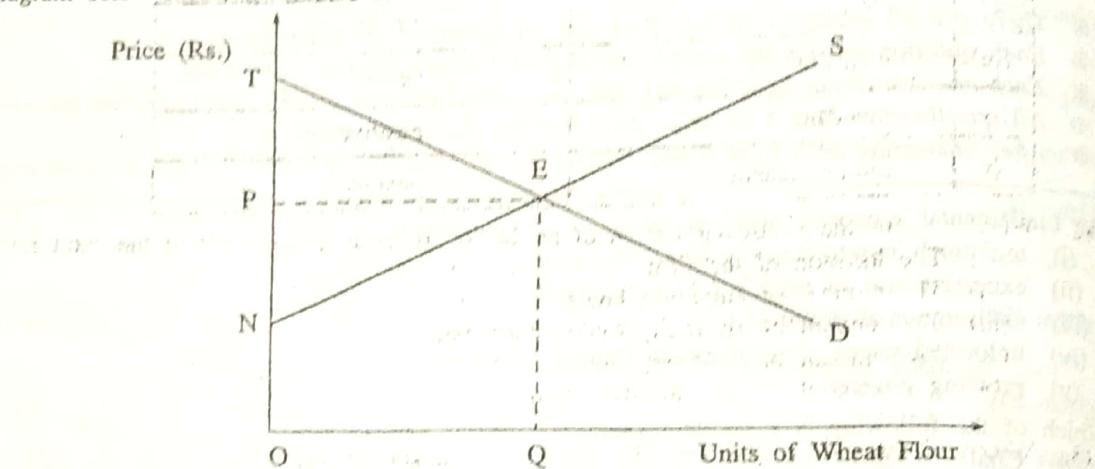
	Current living standards	Future living standards
(i)	decrease	decrease
(ii)	decrease	increase
(iii)	increase	decrease
(iv)	increase	increase
(v)	increase	remain unchanged

(See page 2)

4. Which one of the following is most likely to result from increased specialisation?
- Lower production
  - Higher unit costs
  - Lower wages per worker
  - Higher productivity
  - Low level of technology

5. In a market economy, the price mechanism can achieve all the following except
- signaling changes in consumer tastes.
  - causing supply to respond to changes in demand.
  - eliminating excess supply and excess demand.
  - ensuring the fair distribution of all types of goods.
  - rationing limited resources among alternative uses.

6. The diagram below shows the supply curve (NS) and the demand curve (TD) for wheat flour.



Which one of the following areas represents producer surplus?

- NTE
- TPE
- NPE
- NEQO
- OPEQ

7. The income elasticity of demand for an inferior good is,

- zero.
- Inelastic.
- Unitary.
- Negative.
- Positive.

8. A manufacturer reduces the price of an electric bulb by 5% and, as a result, the volume of sales of electric bulbs rises by 2%. The price elasticity of demand for electric bulbs is,

- 0.4
- 0.8
- 2.5
- 4.0
- 10.0

9. If demand for a product is price elastic, total revenue will

- decrease if price is increased.
- increase regardless of the direction of price change.
- increase if price is increased.
- be unchanged regardless of the price change.
- decrease if price is reduced.

10. When a minimum price is imposed on a good by the government,
- excess supply will result.
  - excess demand will result.
  - trading will continue at the equilibrium price
  - firms will sell the quantity they wish at this price.
  - consumer surplus will increase.
11. "Total expenditure on good X rises if its price falls, but decreases if income falls." Identify the correct combination relevant to the above statement from the following.
- | Price elasticity of demand for good X | Income elasticity of demand for good X |
|---------------------------------------|--|
| (i) elastic                           | negative                               |
| (ii) elastic                          | positive                               |
| (iii) inelastic                       | negative                               |
| (iv) inelastic                        | positive                               |
| (v) unitary elastic                   | positive                               |
12. Which one of the following factors of production is likely to be fixed in the short run?
- The location of the firm
  - The number of employee hours
  - The amount of electricity (units) consumed
  - The amount of stationery used
  - The amount of raw materials used
13. Which of the following necessarily represent a market failure?
- Rising cost of production
  - Prices rising because of increase in demand
  - Firms closing down because the goods they produce are no longer needed
  - Producers being unable to charge a price for the external benefits they create
  - Private costs and social costs are equal
14. Net domestic product at market prices equals
- consumption expenditure + government purchases + net exports + investment expenditure
  - consumption expenditure + government purchases + exports + personal taxes
  - indirect business taxes + personal income + net exports - depreciation
  - all factor incomes + indirect taxes - subsidies
  - all factor incomes - depreciation
15. When other things remain unchanged, an increase in household disposable income leads to
- decrease in consumption and increase in saving
  - increase in consumption and decrease in saving
  - increase both savings and consumption
  - consume the entire increase in income
  - save the entire increase in income
16. Which of the following is not a component of aggregate demand
- Exports
  - Private consumption
  - Productivity
  - Investment
  - Government consumption

17. Refer to the following information (Data is in Rs. Millions).

Saving	=	550	Investment	=	400
Taxation	=	200	Total government expenditure	=	250
Imports	=	250	Exports	=	300

Which of the following statements is correct?

- (i) Total output will increase and the budget is in surplus
- (ii) Total output will increase and the budget is in deficit
- (iii) Total output will decrease and the budget is in surplus
- (iv) Total output will decrease and the budget is in deficit
- (v) Total output will not change

18. Without government intervention, which one of the following is most likely to be under-produced in a market economy?

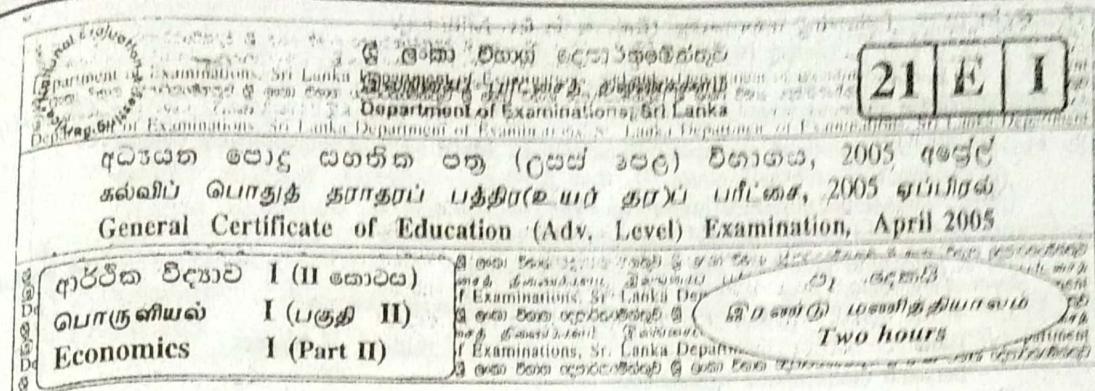
- (i) Normal goods
- (ii) Merit goods
- (iii) Luxury goods
- (iv) Private goods
- (v) Inferior goods

19. An example of a pure public good is,

- (i) national defense.
- (ii) a loaf of bread.
- (iii) education.
- (iv) a television.
- (v) a highway.

20. A deficit financed by borrowing

- (i) will always increase aggregate consumption expenditure
- (ii) does not affect the national debt if the funds come from foreign sources
- (iii) increases the national debt
- (iv) always increases the money supply
- (v) does not affect mobilization of real resources



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

**Sub-section A**  
(Select two questions from this section)

- (a) What do you mean by "economic resources". (02 marks)
- (b) Outline the characteristics of a mixed economy. (03 marks)
- (c) Outline the ways in which the price mechanism allocates resources among alternative uses in a free market economy. (05 marks)
- (d) Examine the main shortcomings of price mechanism as a means of allocating resources. (05 marks)

Distinguish between the concepts in each of the following pairs.

- (a) Needs and wants
- (b) Money costs and opportunity costs
- (c) Nominal national income and real-national income
- (d) Normal profit and supernormal profit (03 marks each)
- (e) Fixed costs and variable costs

The market demand and supply functions for a commodity sold in a competitive market are given below:

$$Q_D = 20 - P \quad (\text{demand function}) \qquad Q_S = -8 + 6P \quad (\text{supply function})$$

- (a) Determine the equilibrium price and quantity of this commodity. (04 marks)
- (b) Suppose demand function changes to  $Q_D = 36 - 5P$  while supply function remains unchanged. Determine the new equilibrium price and quantity. (04 marks)
- (c) Suppose supply function changes to  $Q_S = -10 + 4P$  while the market demand function remains unchanged at its original level. What will be the new equilibrium price and quantity. (04 marks)
- (d) Draw a diagram to show the conditions described in parts (a), (b) and (c). (03 marks)

- (a) Using relevant diagrams, explain the effects of the following events on the market for fish which is operating under competitive conditions:

- (i) Destruction of a substantial part of fishing vessels due to Tsunami waves
- (ii) A fall in consumer preference for fish
- (iii) A fall in the price of chicken
- (iv) A payment of fuel subsidy to fishermen
- (v) Major improvement in fishing technology with assistance from the donor countries (02 marks each)

- (b) "When you move along the demand curve, you must hold income constant. Yet one factor that can cause a change in the quantity demanded is an 'income effect'." Explain. (05 marks)

## Sub-section B

(Select two questions from this Section)

5. (a) Briefly explain macroeconomic equilibrium in an open economy. (04 marks)

- (b) Identify the components of aggregate expenditure to which each of the following belongs:
- Construction of a new house
  - An increase in furniture inventories over last year's level
  - Recruitment of unemployed graduates into public service
  - A household purchases one hour of legal advice

- (c) You are given the following information about a hypothetical economy: (04 marks)

Item	Billions of Rupees
Personal consumption expenditure	200
Personal taxes	50
Exports	30
Depreciation	10
Government purchases	50
Gross private domestic investment	40
Imports	40
Government transfer payments	20
Changes in inventories	05

Using relevant data compute the following: (02 marks)

- GDP (01 mark)
- Net Domestic Product (01 mark)
- Net Investment (01 mark)
- Net exports (01 mark)
- National savings (02 marks)

6. Some information pertaining to aggregate consumption and investment in a simple economy is given below:

- Autonomous (determined independent of current income) consumption = Rs. 50 million.
- Every one rupee increase in income causes 75 cents increase in consumption.
- Investment = Rs. 100 million.

- Using the above information, construct the consumption and savings functions for this economy. (05 marks)
- Determine the equilibrium level of national income for this economy. (05 marks)
- Draw consumption, savings and investment functions in a diagram and show the determination of equilibrium level of income. (05 marks)

7. (a) Give an example for each of the following.

- A good rivalrous in consumption and excludable (01 mark each)
  - A good non-rivalrous in consumption and excludable (01 mark each)
  - A good non-rivalrous in consumption and non-excludable (01 mark each)
- For what economic reasons might there be public hostility to the transfer of publicly-owned assets to the private sector. (06 marks)
  - "Markets do not always achieve desirable outcomes for consumers, producers and other groups and this leads to the need for government intervention". Discuss this statement using relevant examples from Sri Lanka. (06 marks)

- What are the major components of government current expenditure in Sri Lanka? (05 marks)
- What changes do you observe in Sri Lanka's government current expenditure during the period 2001 - 2003? (05 marks)
- What are the economic implications of these changes? (05 marks)



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1. The monetary aggregate  $M_2$  is defined as

  - all assets which are highly liquid but which themselves cannot be used for day-to-day transactions.
  - $M_1$  plus close substitutes such as savings and NRFC deposits which are easily converted into  $M_1$ .
  - $M_1$  plus all assets which can be converted into  $M_1$ .
  - $M_1$  plus Certificates of Deposits plus Credit and Debit Card balances.
  - $M_1$  plus savings and time deposits at the commercial banks held by the public.

2. Which of the following is the least liquid of the assets of a commercial bank?

  - Treasury bills
  - Balances at the Central Bank
  - Cash in tills
  - Advances to customers
  - Money at call

3. The Central Bank can decrease the money supply by

  - selling bonds to the public.
  - lowering reserve requirements.
  - lowering the discount rate.
  - buying foreign exchange.
  - open market purchases.

The Table below shows the values of selected economic variables expressed in the form of index numbers.

Year	Price level	Money supply	Velocity of circulation	Number of final transactions
1	100	100	100	100
2	- ? -	120	100	80

What is the index for the price level in Year 2?

- (i) 100
  - (ii) 120
  - (iii) 150
  - (iv) 180
  - (v) 200

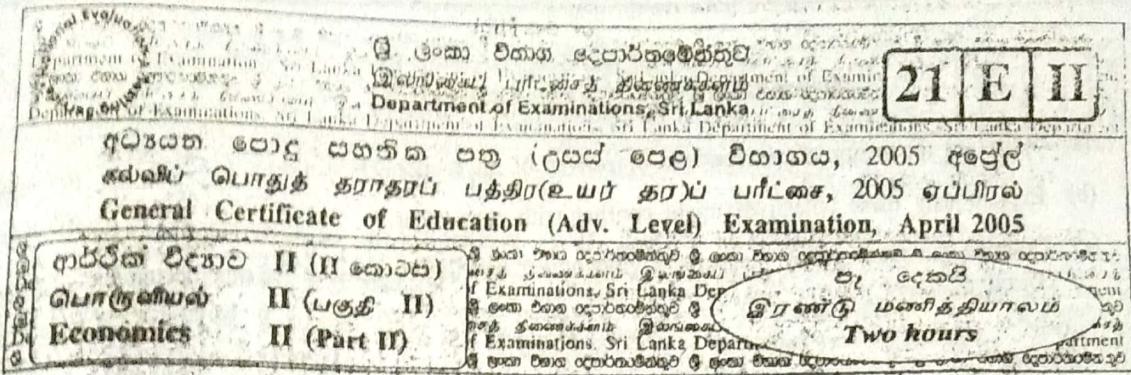
5. If both nominal national income and the price level doubled  
 (i) nominal income would be increasing.  
 (ii) real income would be increasing.  
 (iii) inflation exists.  
 (iv) relative prices would be increasing.  
 (v) both (i) and (iii) are possible.
6. The principle of comparative advantage suggests that trade between countries will be beneficial whenever there are differences between countries in  
 (i) labour costs  
 (ii) opportunity cost ratios  
 (iii) productivity  
 (iv) prices  
 (v) transport costs
7. The Table below shows indicators of a country's economic performance over a two year period.
- | Year | Exchange rate | Volume of exports index | Volume of imports index | Balance of trade (SDR) |
|------|---------------|-------------------------|-------------------------|------------------------|
| 1    | 100           | 100                     | 100                     | 0                      |
| 2    | 100           | 90                      | 100                     | + 300 million          |
- Which of the following is consistent with the above information?
- (i) There has been a fall in the price of exports.  
 (ii) There has been an improvement in the terms of trade.  
 (iii) There has been an increase in the price of imports.  
 (iv) There has been no change in the level of real income per head.  
 (v) There has been a depreciation of the exchange rate.
8. An adverse movement in the terms of trade means that
- (i) the volume of exports has fallen  
 (ii) the price of exports have risen  
 (iii) the value of earnings from exports has fallen  
 (iv) the prices of exports have fallen relative to the prices of imports  
 (v) the volume of exports has fallen relative to the volume of imports
9. Which of the following is included in the Capital and Financial Account of the Sri Lankan balance of payments?
- (i) dividends paid to foreign investors  
 (ii) expenditure by German tourists in Sri Lanka  
 (iii) expenditure by Sri Lankan tourists in Japan  
 (iv) receipt of privatization proceeds from Indian investors who purchased Sri Lanka Petroleum Corporation assets  
 (v) interest payments for loans granted by the Asian Development Bank
10. The external value of Sri Lankan Rupee is most likely to depreciate if
- (i) the Sri Lankan Government borrows more money abroad  
 (ii) the Sri Lankan government receives more foreign grants to help Tsunami victims  
 (iii) tariffs are raised on goods entering Sri Lanka  
 (iv) Sri Lanka reverts to the fixed exchange rate system  
 (v) Sri Lanka's inflation rate rises above those of other countries.
11. Economic growth is usually defined as
- (i) the subtraction of the rate of increase in labour force from the rate of increase in output  
 (ii) a sustained increase in real output over time  
 (iii) the increase in input availability  
 (iv) the reduction in the real cost of necessities  
 (v) the increase in nominal national income

12. The domestic savings ratio in Sri Lanka in recent years (2001 – 2003) has been:
- 12% - 14%
  - 14% - 16%
  - 16% - 18%
  - 18% - 20%
  - 20% - 22%
13. If there has been a 6% increase in nominal GDP, a 4% increase in the price level, and a 2% increase in the population, real GDP per capita has changed by:
- 2%
  - 0%
  - 2%
  - 6%
  - None of the above
14. A benefit that cannot be expected from the improvement of labour productivity is:
- increase in living standards of people
  - attracting foreign direct investment into the country
  - increase in export earnings
  - increase in the rate of economic growth
  - removal of disparities in income distribution
15. Which of the following alternative combinations correctly identifies the effects that occur when some of those who are categorized as unemployed stop actively looking for work?

	Size of the Labour Force	Labour Force Participation Rate	Unemployment Rate
(i)	increases	increases	increases
(ii)	decreases	decreases	decreases
(iii)	decreases	increases	decreases
(iv)	increases	decreases	increases
(v)	decreases	decreases	increases

16. Which one of the following groups can be considered as underemployed population?
- People who are willing to work and unable to find jobs
  - Employed population in the labour force who hold two or more jobs
  - People who have resigned from their present jobs and are looking for better jobs
  - People work voluntarily for low wages
  - People who are working full-time and hard, yet have a low marginal product
17. Which one of the following is not a Millennium Development Goal?
- Eradication of extreme poverty and hunger
  - Ensure environmental sustainability
  - Improve maternal health
  - Reduce birth rate
  - Develop a global partnership for development
18. Which of the following would reduce the average standard of living in a country?
- A rise in both population and GNP by the same percentage
  - A rise in population and a proportionately smaller rise in GNP
  - No change in population and a rise in GNP
  - A fall in population and no change in GNP
  - A fall in population and smaller proportionate fall in GNP

19. The Human Development Index (HDI) is an aggregation of widely available indicators of basic human needs. Which of the following is not a component of the HDI?
- (i) Life expectancy at birth
  - (ii) Gross enrolment ratio
  - (iii) GDP per capita calculated at purchasing power parity
  - (iv) Infant mortality
  - (v) Adult literacy
20. The Gini coefficient provides a measure of
- (i) the level of absolute poverty
  - (ii) the level of relative income inequality
  - (iii) disguised unemployment
  - (iv) poverty line
  - (v) the rate of economic growth



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

#### Sub-section A

(Select two questions from this section)

1. (a) Assume a competitive banking system in which commercial banks make loans to the full amount of any excess reserves they acquire and the commercial banks operate at a statutory reserve ratio of 25%. They hold deposits from the public of Rs. 2000 million. The total money supply ( $M_1$ ) is Rs. 2500 million.
  - (i) What is the amount of loans that the banks have made? (02 marks)
  - (ii) Assume that the public deposits Rs. 100 million of the notes and coins they hold. Explain what will happen to the total deposits as the banks adjust their final lending. (04 marks)
  - (iii) What is the value of money supply ( $M_1$ ) after all adjustments have been made? (04 marks)
- (b) Explain why the amount of credit created in practice may be less than what the deposit multiplier suggests. (05 marks)
  
2. (a) How does Open Market Operations of the Central Bank affect the level of reserves of the banking system? (05 marks)
- (b) What is the effect of the Open Market Operations on the money market? (05 marks)
- (c) Explain the effect of the change in money market on aggregate demand. (05 marks)
  
- (a) What is the difference between absolute advantage and comparative advantage? (05 marks)
- (b) Identify the sources of comparative advantage? (05 marks)
- (c) What arguments have been made in support of protectionism? (05 marks)
  
- (a) What is meant by the 'managed floating exchange rate regime'? (05 marks)
- (b) Explain the difference between depreciation and devaluation of the external value of a currency? (05 marks)
- (c) Will a depreciation of the exchange rate necessarily improve the balance of trade of an economy? (05 marks)

## Sub-section B

Select two questions from this Section

5. (a) What are the major *macroeconomic* objectives of an economy? (05 marks)
- (b) Explain why these objectives might conflict with each other. (05 marks)
- (c) Describe the main policy measures a government can use to achieve its macroeconomic objectives. (05 marks)
6. (a) Examine the trends in national poverty level in Sri Lanka in the period 1990 - 2002. (05 marks)
- (b) Give reasons for the existence of high poverty levels in the rural sector as compared with the urban sector in Sri Lanka. (05 marks)
- (c) Outline the various programmes implemented in Sri Lanka in recent years for reducing poverty. (05 marks)
7. "Growth rate in the agricultural sector of Sri Lanka has been very low due to deep-rooted structural weaknesses".
- (a) Compare the contribution of the agricultural sector to the GDP with that of industry and services sectors during the period 2001 - 2003. (05 marks)
- (b) Identify the deep-rooted structural weaknesses hindering the growth of agricultural output. (05 marks)
- (c) State the important strategies outlined in the National Policy on Agriculture and Livestock (NPAL) to promote agriculture. (05 marks)
8. (a) Explain the major factors responsible for the poor performance of the Sri Lankan economy after Independence. (07 marks)
- (b) What recommendations would you like to make to achieve faster and more equitable growth in Sri Lanka? (08 marks)