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කළුවීප පොතුත් තරාතුරු පත්‍තිරූපයර් තරා)ප පරිශෑස, 2009 ඉකෑල්  
General Certificate of Education (Adv. Level) Examination, August 2009

ආර්ථික විද්‍යාව I  
පොරුණීයල් I  
Economics I

පැය තුනයි  
මුළුව් මණ්ඩලයාලම  
Three hours

Index No. : .....

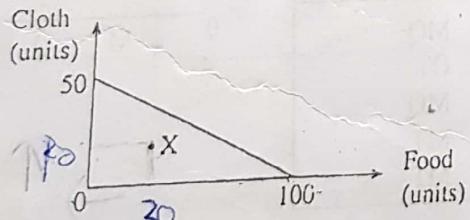
Note: (i) This paper consists of two parts. Part I and Part II.  
(ii) Time allocated for both is three hours.  
(iii) Tie the answer scripts of both part I and part II together and hand over.

### Part I

- \* 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.
- \* All questions in Part I must be answered on this paper itself.
- \* Each multiple-choice question has only one correct answer. Identify and underline the correct answer.

1. The opportunity cost of studying at a private university is likely to include all of the following except one. Which of them is not included?
  - (i) The cost of required textbooks
  - (ii) Tuition fees
  - (iii) The income foregone in order to attend classes during the university sessions
  - (iv) The money spent on hair cuts during the university sessions
  - (v) The cost of paper and pencils needed to take notes
2. The degree of government involvement in the economy is greatest in
 

(i) a command economy.	(ii) a mixed economy.
(iii) a market economy.	(iv) a traditional economy.
(v) a social market economy.	
3. The diagram below shows the production possibility curve for a hypothetical economy.



At point X in the diagram, the opportunity cost of producing food

- (i) cannot be determined.
- (ii) is infinite since it is impossible to produce more of food.
- (iii) is greater than the opportunity cost of cloth.
- (iv) is less than the opportunity cost of cloth.
- (v) is zero.

4. Japan is one of the countries that have been adversely affected by current global economic recession. The immediate impact of the recession on the Japanese economy is
- an outward shift in its production possibility frontier.
  - an inward shift in its production possibility frontier.
  - a movement from a point inside the production possibility frontier to the boundary.
  - a movement to a point further inside of its production possibility frontier.
  - an increase in prices of most goods because scarcity has increased.

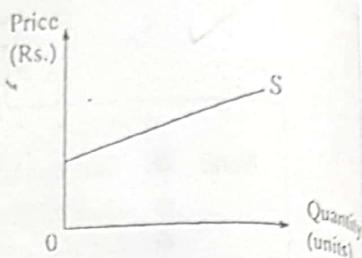
5. Which one of the following is not an example of capital as a factor of production?

- An office building
- A tractor
- A bank loan
- A road
- An irrigation canal

6. The diagram shows a market supply curve of a commodity.

Which statement correctly describes the price elasticity of supply along this curve?

- It is constant and greater than unity at all quantities.
- It is constant and less than unity at all quantities.
- It is greater than unity and diminishes as quantity increases.
- It is greater than unity and increases as quantity increases.
- It is negative and diminishes as quantity increases.



7. The table below shows the total and marginal costs of a firm.

Output (units)	Total cost (Rs.)	Marginal cost (Rs.)
1	200	20
2	215	15
3	225	10
4	240	15
5	260	20
6	285	25

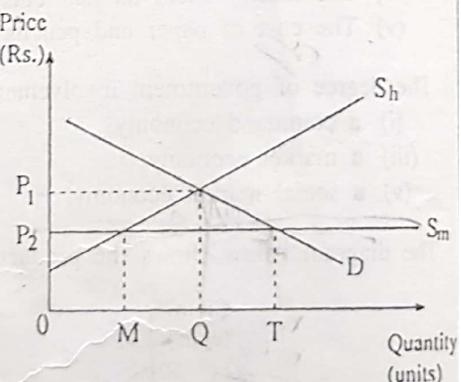
What is the average fixed cost of producing 5 units?

- Rs. 20
- Rs. 36
- Rs. 52
- Rs. 180
- Rs. 200

8. The diagram shows a market for a good which is supplied partly from domestic production and partly from imports.  $S_h$  represents domestic supply and  $S_m$  represents imports. D represents market demand.

When the market is in equilibrium, what will be the total quantity demanded and the associated quantity of imports?

Total quantity demand	Quantity of imports
OQ	MQ
OQ	OT
OT	MQ
OT	MT
OQ	MT



9. A perfectly competitive firm which is producing 200 eggs per week, sells an egg for Rs. 25. This output of 200 eggs per week incurs the following costs:

$$\begin{array}{lcl} \text{Total fixed cost} & = & \text{Rs. 2000} \\ \text{Total variable cost} & = & \text{Rs. 4000} \\ \text{Marginal cost} & = & \text{Rs. 25} \end{array}$$

In the short run, what should the firm do to maximize its profits or minimize its losses?

- Raise its price
- Increase output
- Decrease output
- Maintain output at its present level
- Cease production altogether

- 10 A perfectly competitive firm's perfectly elastic demand curve means that

  - it could actually sell an infinite amount of output at the going price.
  - the firm could increase total revenue by increasing the price.
  - as the firm expands the output its marginal revenue will fall.
  - total revenue is constant regardless of quantity produced.
  - the product's price will be virtually unaffected at any output levels the firm can reasonably produce.

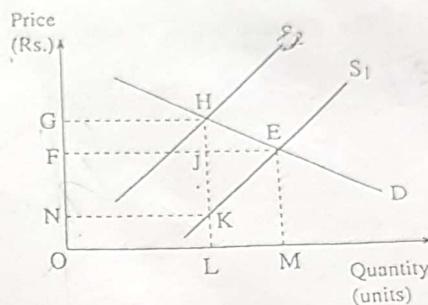
11. The government imposes a sales tax to reduce consumption of a certain good. Which combination of price elasticity of demand and price elasticity of supply will have the greatest effect on the reduction of consumption?

  - Elastic demand and elastic supply
  - Elastic demand and inelastic supply
  - Inelastic demand and elastic supply
  - Inelastic demand and inelastic supply
  - Unitary elastic demand and unitary elastic supply

12. As shown in the diagram, when the government imposes an indirect tax on a certain product, the supply curve shifts from  $S_1$  to  $S_2$ .

The government's tax revenue is

  - NFJK
  - OGHL
  - FGHJ
  - NGHK
  - FEHG



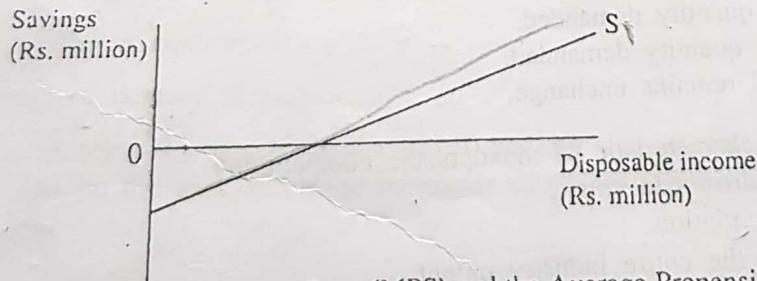
13. The table below shows selected macroeconomic data for a hypothetical economy.

Item	(Rs. Billion)
Savings	50
Investment	30
Taxation	40
Exports	50
Government purchases	20
Imports	30

Which statement is correct for the economy according to the information given in the table?

- (i) There is a budget deficit.
  - (ii) The economy is in equilibrium.
  - (iii) There is a current account deficit in the balance of payments.
  - (iv) Withdrawals are greater than injections.
  - (v) Economy will expand.

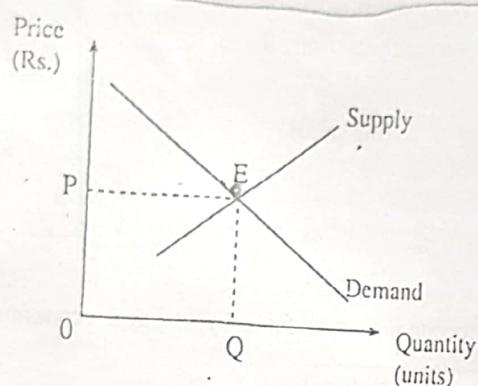
14. The diagram shows the aggregate savings function in a given economy.



What happens to the Marginal Propensity to Save (MPS) and the Average Propensity to Save (APS) as disposable income rises in this economy?

	MPS	APS
(i)	remains constant	falls
(ii)	falls	rises
(iii)	rises	falls
(iv)	rises	rises
(v)	remains constant	rises

15. Suppose the Marginal Propensity to Consume (MPC) for a closed economy is 0.8. An increase in investment leads to an increase in national income by Rs. 250 billion. Other things being equal, what is the value of increase in investment?
- Rs. 20 billion
  - Rs. 50 billion
  - Rs. 150 billion
  - Rs. 200 billion
  - Rs. 250 billion
16. For an inferior good
- price elasticity of demand is negative and the income elasticity of demand is negative.
  - price elasticity of demand is positive and the income elasticity of demand is negative.
  - price elasticity of demand is negative and the income elasticity of demand is positive.
  - price elasticity of demand is positive and the income elasticity of demand is positive.
  - price elasticity of demand is less than one and income elasticity of demand is more than one.
17. The diagram below illustrates the free market demand and supply curves for a merit good.



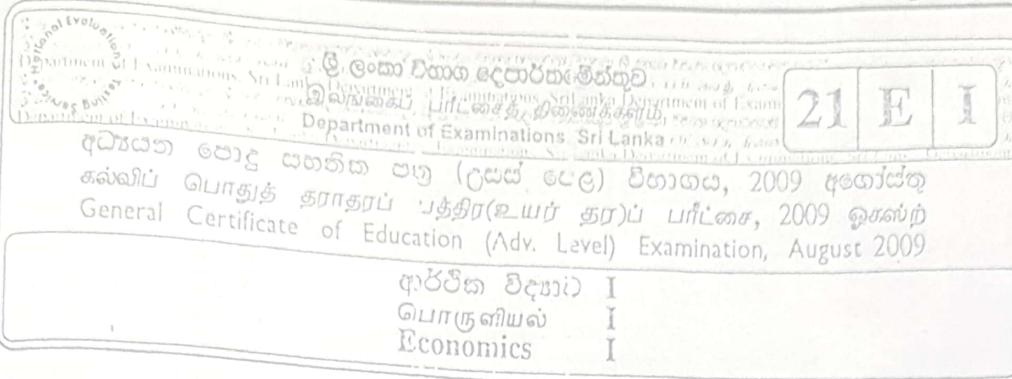
At the free market equilibrium position shown in the diagram at point E, there is a misallocation of resources because consumption of the good creates a positive externality. To improve the allocation of resources

- the existing quantity of the good should be supplied at a higher price.
- more of the good should be supplied at a lower price.
- the demand curve should shift to the left.
- the elasticity of demand for the good should be increased.
- a unit tax should be imposed on the production.

18. Given the demand curve  $Q_d = 120 - 8P$  and a market price of  $P = 10$ , the consumer surplus is Rs.
- 15
  - 100
  - 112
  - 120
  - 400

19. If the price elasticity of demand for cigarettes is -0.5 and a 20% increase in price of cigarettes would result in
- 10% decrease in the quantity demanded.
  - 20% decrease in the quantity demanded.
  - 50% decrease in the quantity demanded.
  - 100% decrease in the quantity demanded.
  - the quantity demanded remains unchanged.

20. Which of the following is a characteristic of monopolistic competition?
- There are substantial barriers to entry.
  - There is product differentiation.
  - A single firm produces the entire industry output.
  - Each firm's demand curve is horizontal at the market price
  - Both buyers and sellers have perfect information.



## Part II

*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.)

- (i) Define the term 'opportunity cost'. (02 marks)
- (ii) What is the 'law of increasing opportunity cost'? (02 marks)
- (iii) How does the production possibility curve reflect the law of increasing opportunity cost? (04 marks)
- (iv) Give reasons for the law of increasing opportunity cost. (02 marks)
- (v) What are the conditions required for production efficiency and allocative efficiency? (05 marks)
  
- (i) What are the main characteristics of a market economy? (04 marks)
- (ii) What is the role of profit in a market economy? (03 marks)
- (iii) Would the market economy always be able to allocate resources efficiently? Explain your answer. (04 marks)
- (iv) What are the criteria to be used in the evaluation of performance of an economic system? (04 marks)

The demand and supply curves for a good sold in a competitive market are given by the following equations:

$$Q_d = 30 - 2P \quad Q_s = -2 + 2P$$

In the equations above,  $Q_d$  and  $Q_s$  are the quantities demanded and supplied respectively and P is the price in rupees.

- (i) Determine the equilibrium price and quantity for this market. (04 marks)
- (ii) Calculate the producer surplus at equilibrium. (04 marks)
- (iii) What is the price elasticity of demand at equilibrium? (04 marks)
- (iv) Suppose the government imposes a floor price equal to Rs. 10 per unit without taking any price supportive action. What will be the excess demand or excess supply in the market resulting from the floor price? (03 marks)
  
- (i) Define the term 'economies of scale'. (02 marks)
- (ii) How do the economies of scale arise? (04 marks)
- (iii) State three characteristics of an oligopolistic market. (03 marks)
- (iv) Explain what is meant by the term 'barriers to entry' (02 marks)
- (v) What is the lowest price at which a perfectly competitive firm produces an output in the short run? Explain why? (04 marks)

Sub Section B  
(Select two questions from this section.)

5. (i) What is meant by 'underground economic activities'? (0)

(ii) The following is a list of macroeconomic data for a hypothetical economy:

Item	Value (in billion rupees)
Personal consumption	65 000
Government purchases	15 000
Gross domestic fixed capital formation	18 000
Change in inventories	2 000
Exports	20 000
Imports	30 000
Net foreign factor incomes	- 5 000
Net foreign private transfers	3 000
Net foreign official transfers	1 000

Estimate the following: (02)

(a) Gross Domestic Expenditure (02)

(b) Gross Domestic Product at market prices (02)

(c) Gross National Product at market prices (02)

(d) Disposable Gross National Income (02)

(e) Domestic Savings and National Savings (03)

6. (i) What do you understand by the term 'economic recession'? (02)

(ii) Define 'aggregate demand'? (02)

(iii) How does aggregate demand determine the level of income? (04)

(iv) Explain how changes in savings and investment influence the level of economic activity. (04)

(v) How is the equilibrium level of income determined in an open economy? (03)

7. (i) Define the term 'market failure'. (03)

(ii) Describe why externalities generate market failures. (04)

(iii) Explain two reasons why education is not a 'public good'. (02)

(iv) Distinguish between 'merit goods' and 'demerit goods' and give an example for each category. (06)

8. (i) What are the relative shares of direct and indirect taxes in total tax revenue in Sri Lanka? (02)

(ii) Examine the trend of Sri Lanka's overall budget deficit in recent years. (03)

(iii) Using appropriate diagrams, compare the incidence of a specific sales tax imposed on buyers and a specific excise tax imposed on sellers in a given market. (05)

(iv) "The recent trends of public revenue in Sri Lanka show no close association with the growth of GDP." What measures would you recommend to improve the revenue performance of the central government of Sri Lanka? (05)

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 ජාතිය, 2009 අගෝස්තු  
 General Certificate of Education (Adv. Level) Examination, August 2009.

ආර්ථික තිද්‍යාල II  
 පොරුග්‍රැස්‍යල් II  
 Economics II

පැය තුනකි  
 මුන්තු මණිත්තියාලම  
 Three hours

Index No. : .....

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### Part I

- \* There are 20 questions in this Part and all questions are compulsory.
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When other factors remain constant, what will cause a reduction in the stock of money?

- A balance of payments surplus
- An increase in the public's demand for bank advances
- An increase in the public's desired ratio of cash to bank deposits
- An increase in the government's borrowing from the banking system
- A decrease in the statutory reserve ratio

A commercial bank has excess reserves of Rs. 10 000 and deposit liabilities of Rs. 80 000. If the reserve ratio is 20%, then the bank has actual reserves of

- Rs. 6 000
- Rs. 16 000
- Rs. 20 000
- Rs. 26 000
- Rs. 36 000

When commercial banks reduce their holdings of excess reserves,

- the money supply falls.
- the monetary base increases.
- the money supply increases.
- the monetary base falls.
- the deposit multiplier falls.

When the Central Bank sells government securities to a commercial bank,

- reserves in the banking system increase.
- reserves in the banking system remain unchanged.
- reserves in the banking system decline.
- Central Bank's liabilities remain unchanged.
- money supply will increase.

In a given year, it was found that the money supply in a certain economy had decreased, but the nominal value of its Gross National Product (GNP) and the price level had both remained unchanged. Which of the following must also have occurred during the year?

- A decrease in the interest rate
- An increase in the velocity of circulation of money
- A decrease in the velocity of circulation of money
- A decrease in real GNP
- An increase in the demand for money

6. What action could the Central Bank take in order to reduce the rate of inflation?
- Sell government securities to create a surplus of funds in the market.
  - Sell government securities to create a shortage of funds in the market.
  - Buy government securities to create a surplus of funds in the market.
  - Buy government securities to create a shortage of funds in the market.
  - Lower the statutory reserve ratio to create a shortage of funds in the market.
7. Comparative advantage means that one country can produce
- more of one product than another country.
  - one product at lower marginal cost than another country.
  - one product at lower long-run average total cost than another country.
  - one product at lower opportunity cost than another country.
  - more of one product than of another product.
8. Sri Lanka's largest export market is
- USA
  - UK
  - Japan
  - Germany
  - India
9. In which account of balance of payments are portfolio investment transactions recorded?
- The capital account
  - The current account
  - The financial account
  - The transfer account
  - The income account
10. The table below shows selected data from a balance of payments account for a hypothetical economy.
- | Item                          | Rs. billion |
|-------------------------------|-------------|
| Balance on goods and services | -12         |
| Net current transfers         | 4           |
| Net income                    | ?           |
| Capital account               | 20          |
| Financial account             | 10          |
| Overall balance               | 16          |
- What is the value of the net income of the balance of payments related to this economy?
- Rs. - 6 billion
  - Rs. 6 billion
  - Rs. 14 billion
  - Rs. -14 billion
  - Rs. 16 billion
11. The table shows alternative price elasticities of demand for exports and imports of a hypothetical economy. If there is a depreciation of the currency of this economy, which combination of price elasticities offer the best prospect for an improvement in the balance of trade?
- |       | Exports | Imports |
|-------|---------|---------|
| (i)   | 0.5     | 1.5     |
| (ii)  | 0.5     | 0.4     |
| (iii) | 0.8     | 0.6     |
| (iv)  | 1.0     | 1.4     |
| (v)   | 2.3     | 0.8     |
12. The real exchange rate is
- the nominal exchange rate adjusted for relative inflation rates at home and abroad.
  - the price of foreign exchange divided by Consumer Price Index of previous year.
  - the Consumer Price Index divided by nominal exchange rate of home country.
  - the weighing of the nominal exchange rate index of each trading partner.
  - the difference between nominal effective exchange rate and real effective exchange rate.
13. 'Internal balance' refers to
- full employment and a reduced foreign debt.
  - price stability and a stable exchange rate.
  - full employment and price stability.
  - a reduced foreign debt and low inflation.
  - maintaining a balanced budget and higher rate of economic growth.

14. Which one of the following is most likely to be an example of a supply-side economic policy?
- A reduction in the rate of interest to reduce inflation
  - An increase in government expenditure on state pensions
  - A reduction in company taxes to encourage greater investment by private sector
  - A rise in the exchange rate to increase exports
  - Nationalization of private sector enterprises
15. Economic development refers to
- economic growth.
  - economic growth plus desirable changes in income distribution and economic structure.
  - improvement of the well-being of the urban population.
  - sustainable increase in Gross National Product.
  - elimination of relative poverty.
16. The Human Development Index (HDI) summarizes a great deal of socio-economic performance in a single composite index, combining
- infant mortality, life expectancy and adult literacy rate.
  - health, education and environment.
  - minimum schooling, adult literacy and clean environment.
  - nutrition, adult literacy and quality of housing.
  - longevity, education and living standard.
17. The value of Special Drawing Rights (SDR) is based on a market exchange rate of a few major currencies. These currencies are
- Euro, US dollar, Yen, Sterling Pound and Singapore dollar.
  - Euro, US dollar, Sterling Pound and Yen.
  - Euro, US dollar, Riyal, Sterling Pound and Yen.
  - Euro, US dollar, Sterling Pound and Canadian dollar.
  - Euro, US dollar, Canadian dollar, Sterling Pound and Yen.
18. The Ten Year Horizon Development Framework of Sri Lanka focuses on three main areas in the strategy for improving the socio-economic conditions of the entire island. These three areas are
- reduction of public debt, improving domestic agriculture and improving tourism.
  - infrastructure development, rural development and safety net to the needy segments.
  - infrastructure development, improving environment and industrial development.
  - infrastructure development, human capital development and enterprise development.
  - human capital development, rural development and strengthening of state-owned enterprises.
19. National poverty level of Sri Lanka in the year 2006/07 was
- |           |            |             |            |           |
|-----------|------------|-------------|------------|-----------|
| (i) 15.2% | (ii) 22.7% | (iii) 26.1% | (iv) 28.8% | (v) 32.0% |
|-----------|------------|-------------|------------|-----------|
20. Which of the following Millennium Development Goals (MDG) has Sri Lanka already achieved a significant progress in?
- Eradication of poverty and achieving universal primary education.
  - Reduction of child mortality and suppression of HIV, malaria and other diseases.
  - Improvement of maternal health and ensuring environment sustainability.
  - Promotion of gender equality and eradication of poverty.
  - Achievement of universal primary education and promotion of gender equality.

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Part II

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. (i) Outline the main functions of money.  
 (ii) Why do people hold money when higher yielding assets are available?  
 (iii) What is meant by 'sovereign credit rating'?  
 (iv) Identify three important sources of raising funds by the commercial banks in Sri Lanka.  
 (v) How does the reverse repurchase activities of the Central Bank affect the interest rates in the call money market?
2. (i) What are the target variables chosen by the Central Bank of Sri Lanka in the implementation of the monetary policy at present?  
 (ii) What are the main features of the tight money policy adopted by the Central Bank of Sri Lanka in recent years to maintain economic stability?  
 (iii) Distinguish between 'headline inflation' and 'core inflation'.  
 (iv) State three main factors that have contributed to accelerate the rate of inflation in Sri Lanka during the period 2005—2008.
3. The following table depicts hypothetical production possibilities for country A and country B each producing food and cloth.

Country A		Country B	
Food (units)	Cloth (units)	Food (units)	Cloth (units)
0	500	0	800
200	400	100	600
400		200	400
600		300	200
800		400	0
1 000		—	—

- (i) Assuming that there is a fixed opportunity cost in each country, complete the table. (04 marks)
- (ii) Draw the production possibility curves for the two countries on separate graphs. (02 marks)
- (iii) If the two countries are engaged in trade, which good does each country specialize in? Explain. (02 marks)
- (iv) If 1 unit of food trades for 1 unit of cloth, draw the consumption possibility frontiers for each country on the graphs drawn by you earlier. (04 marks)
- (v) Before trade, assume that country A consumed 600 units of food and 200 units of cloth. After trade, how many units of cloth can be consumed by country A, if it continues to consume 600 units of food? (03 marks)

4. (i) Examine the changes that have taken place in the structure of exports and imports of Sri Lanka since 1977. (04 marks)
- (ii) Define 'nominal exchange rate' and 'real exchange rate'. (02 marks)
- (iii) What is meant by an overvalued exchange rate? (04 marks)
- (iv) Name five bilateral and regional trade arrangements that Sri Lanka has pursued in recent years to expand preferential access to markets. (05 marks)

**Sub Section B**  
*(Select two questions from this section.)*

5. "Sri Lanka's 'external resource gap' has widened in recent years."
- (i) How do you estimate the 'external resource gap' in Sri Lanka? (04 marks)
  - (ii) Examine the trends of the external resource gap in Sri Lanka in recent years. (04 marks)
  - (iii) What are the important changes that have taken place in the sources for financing external resource gap in Sri Lanka in recent years? (03 marks)
  - (iv) Discuss the economic implications of these changes. (04 marks)
- (i) Distinguish between 'economic growth' and 'rate of economic growth'. (02 marks)
- (ii) Explain why economic growth is regarded as a major macroeconomic objective by governments. (04 marks)
- (iii) What are the conditions necessary to improve the quality of life through economic growth? (05 marks)
- (iv) Compare the current value of Sri Lanka's Human Development Index (HDI) with other South Asian countries such as India, Pakistan and Bangladesh. (04 marks)
- (i) Distinguish between 'underemployment' and 'disguised unemployment'. (04 marks)
- (ii) Identify the main categories of employed population in Sri Lanka according to their employment status. (04 marks)
- (iii) How do you define 'economically inactive population'? (02 marks)
- (iv) Describe the economic importance of workers' foreign remittances in Sri Lanka. (05 marks)
- (i) "Sri Lanka's growth performance has been well below the potential when compared with East Asian countries." Explain reasons for under-performance of the economy since independence. (05 marks)
- (ii) What are the major challenges facing the government in achieving its ambitious growth targets set in Ten-Year Horizon Development Framework of Sri Lanka? (05 marks)
- (iii) Briefly describe how the current global economic recession has affected the Sri Lankan economy. (05 marks)

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