2008 – ECONOMICS - I / Part -I

(5) iii	(5) v	(9) ii	(13) i	(17) iii
(6) ii	(6) i	(10) iii	(14) iii	(18) iv
(7) ii	(7) i	(11) ii	(15) iv	(19) ii
(8) Iv	(8) iv	(12) iv	(16) iii	(20) ii

2008 – ECONOMICS - I / Part -II

1) - (i) Economic System is a social and institutional arrangement that has been set up in order to solve basic economic problems of a society. An economic system plays 3 functions.

(a) Deciding what product and in what quantity to be produced. (Production decision).

(b) Deciding how to produce goods and services. (Decision of choice of techniques).

(c) Deciding to whom to produce. (Distribution decision).

(ii) There are 3 reasons for the existence of variety of economic systems.

a) Nature and extent of rights for resource ownership= freedom to own private enterprises and wealth, freedom for factor mobility, freedom of choice of a job etc.

b) Mechanism that coordinates the decisions of solving basic economic problems.

c) Objectives of different economic units such as profit maximisation in free market system, bureaucracy in planned system etc. (4 marks)

(iii)
- It uses both mechanisms that we find in free market / centrally planned economies to solve basic economic problems.
- Both private and public sectors of the economy hold the right to resource/wealth ownership.
- Both public and private enterprises can be found.
- Both public and private sectors contribute in providing employment.
- Government consumption and investment is about 12% of the Gross Domestic product of the country. (3 marks)

(iv) Even if the market mechanism plays commendable role in production and distribution of goods and services of an economy, it sometimes shows failures.
- Some of the situations in which market failures can be noted in the distribution of resources efficiently are given below:
  a) Existence of imperfect competition.
  b) Emerging externalities.
  c) Supply of public and welfare goods.
- Market mechanism does not confirm the equal distribution of income among the members of a society.
- Market economic system may face macro economic instability.
- Some markets undergo tremendous fluctuations. E.g. Agricultural products. (05 marks)

(2) (i)
- Disagree.
- Even if a person can utilize all of his scarce resources efficiently by using them carefully, it does not solve the problem of scarcity.
- The problem of scarcity arises, not because of using resources inefficiently, but because of the unavailability of resources to satisfy unlimited wants of the people.
- The problem of scarcity will exist in the world as long as people have unlimited wants and also as long as the resources available to satisfy those wants remain limited.

(03 marks)

(ii)
- The resource endowment (quantity and quality of goods) will remain the same during the said period.
- Technology will not be changed.
- Resources are utilized efficiently in the process of production. (Full employment and full production of the economy can be seen).
- Resources are being used to produce only two products not more or less than that.

(02 Marks)

(iii) If the output of one good cannot be increased without decreasing the output of the other good, it is said that the economy is in production efficiency. In other words, the economy functions at a point on the production possibility curve. This can be shown as follows in a diagram.

Y

Efficient Production

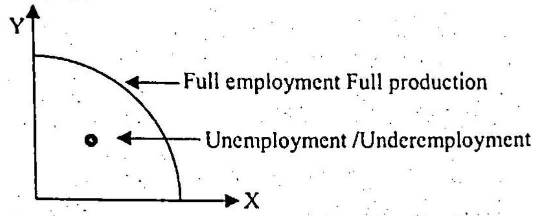
Inefficient Production

X

(01 mark)

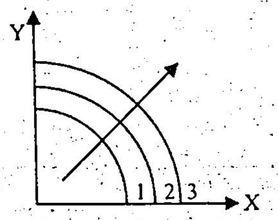
(iv) The PPC can be used in the following way in assessing a country's economic performance.
- Utilizing resources efficiently or inefficiently.
- Economic growth or recession.
- Growth or deterioration or productivity.

Efficient utilization of resources.

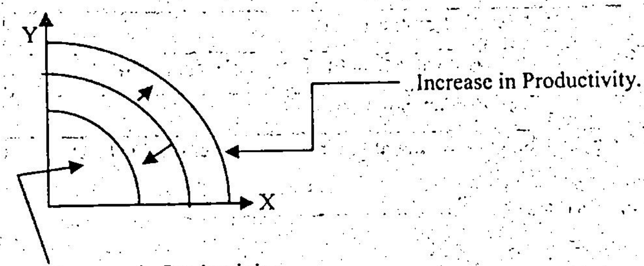


(01 Mark)

Economic growth



Growth and deterioration of productivity



Decrease in Productivity. (01 Mark)

(iii) There are two conditions that must be satisfied if resources are to be utilized efficiently in an economy.
- (Economic Efficiency = Production Efficiency + Allocative Efficiency)

(a). Achieving production efficiency.
(b) Achieving allocative efficiency.

- Production efficiency refers to either obtaining maximum output through some inputs or producing a certain level of output through minimum inputs. Under such circumstances, it is impossible to increase the output of one product without reducing the output of another product. This shows that the economy functions **on** the Production Possibility Curve. (02 Marks)
- Allocative efficiency refers to the idea that the scares resources of a society should be allocated in order to produce the most benefited and essential goods/services to that society.
- Optimum resource allocation is confirmed once the Marginal Cost (MC) of each product equals the price (P). (MC =P). (02 Marks)

(03) (i)- Factor market is the market type that decides about factors of production, land, labour and capital, and the demand for production factors and their factor prices according to the supply. (01 Mark)

- Product market is the market type that decides the price of goods and services according to their demand and supply and the amount of goods being exchanged. (02 Marks)

(ii) Entrepreneurship is the human resource that organizes production with the use of land, labour and capital so as to produce goods and services. (01 Mark)
- Apart from organizing the production process, there are some important functions of an entrepreneur.
  a) Making decisions on business policies.

b) Introducing novelties commercially.
c) Bearing risks of the business. (01 Mark)

(iii) Law of supply.
When all other factors being equal, as the price of a good or service increases, the quantity of goods or services offered by suppliers increases and vice versa. (02 Marks)

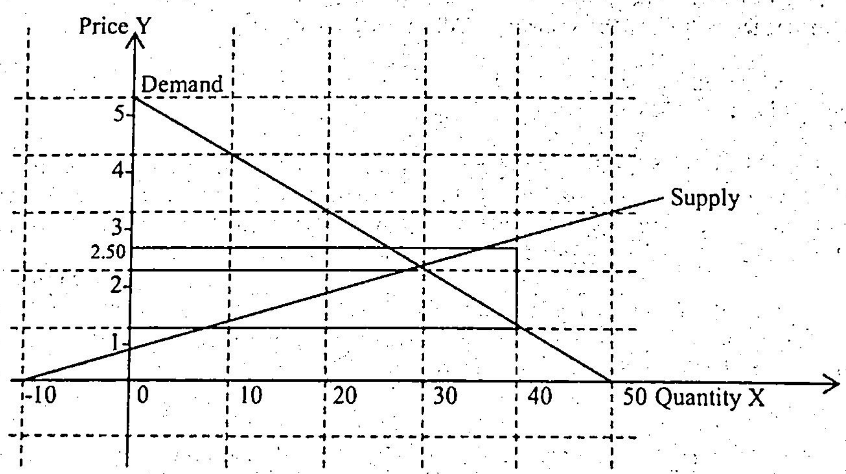
(iv) Marginal Cost increases once the number of units being produced is increased during the short-run in which production capacity and the prices of inputs remain unchanged. (02 Marks)
- Law of increasing opportunity cost describes that the opportunity cost of producing an extra unit increases once the supply is increased. (01 Mark)

(iv)
- Changes in price.
- Changes in technology.
- Changes in market expectations of suppliers.
- Changes in number of suppliers.
- Government rules and regulations.
- Tax and subsidies.
- Changes in climate. (05 Marks)

(04)- (i)

Perfect competition	Monopolistic competition
Homogeneous products	Product is differentiated.
The demand curve of the firm is perfectly elastic.	Demand curve slopes downward.
The selling price of the each supplier is the same.	Products are sold at different prices.
No advertising costs.	Advertising costs exists.
Price equals Marginal cost(P=MC)	Price is greater than the Marginal Cost (P>MC)
Hypothetical Market	Real Market situation.
Functions under normal profits in the long term equilibrium.(minimum AC)	No functioning at the minimum Average Cost.(AC)

(ii) - (a)



(01 Mark)

(b)
- Equilibrium Price = 2/= Rs. (01 Mark)
- Equilibrium quantity = 30 million (limes) (01 Mark)

(c) 40 million limes. (02 Marks)
(d) Market price = 1/=Rs. (02 Marks)
(e) Money received from the government= 1.50x40=60 millon Rs. (03 Marks).

Sub-Section -B

(05) (i). Evaluating functions of the economy/measuring economic growth/international comparison/ estimating the standard of living and welfare of people/identifying structural characteristics of the economy

/identifying functional distribution of the economy/identifying functional relationships of the macro economy/analysing the resource utilization of the economy/planning and formation of economic policies/interpreting the behaviour of macroeconomic variables. (05 Marks)

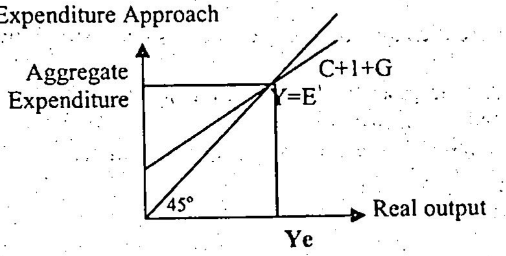
(ii) (a) Included –Factor income
(b) Not included – Transfer payment.
(c) Not included –Transfer payment.
(d) Included – capital payment.
(e) Included – payment made for a productive service. (05 Marks)

(iii) (a) Net National Product at Factor Cost price= National Income.
National Income = Domestic income +Net Foreign Factor Income.
National Income =400+27+38+ (40++15) +30+ (-20) =Rs. 530 billion. (02 Marks)

(b). Disposable Personal Income (DPI) = Personal income-Personal income Tax
DPI = National Income +Transfers-Income not received by households-Personal Income Taxes
DPI = 530+240-55-310=405 billion Rs. (03 Marks)

(6) (i) - There are 3 approaches to calculate the level of national income equilibrium of an economy.
- Total income/expenditure approach (E=Y)
- Leakages equal injections approach. (W=J)
- Aggregated Demand and Aggregate Supply approach. (AD=AS).

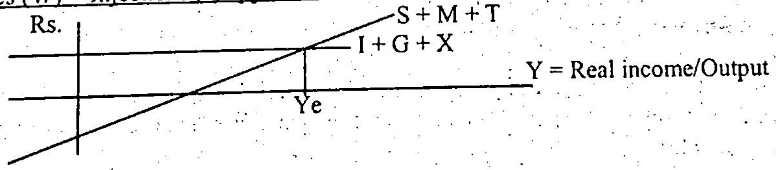
Income –Expenditure Approach



According to this method the equilibrium national income is determined when the expected total expenditure equals the value of real output. In this figure equilibrium income is shown at the point where total expenditure curve (C+I+G) and the 45 degree line intersect each other.

Y<E→ Expansion of income.
Y>E→ Contraction of income.
Y=E→ Stable income+ Equilibrium National Income.

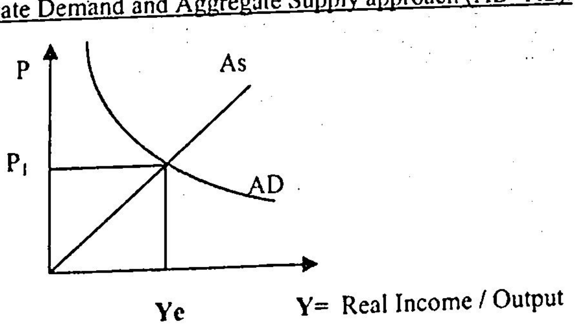
Leakages (W) = Injections (J) approach.



In this approach, equilibrium income is reached when S+T+M = I+G+X.

W>J→ Contraction of income.
W<J→ Expansion of income.
W=J→ Stable income. (Equilibrium National Income).

Aggregate Demand and Aggregate Supply approach (AD=AS).



(05Marks)

(ii) Y+G+I+G+NX

T-G = Budget Deficit

T = Y-YD=5200-4400=800 (01 Mark)

800-G=-150

G=950 (01 Mark)

5200 = 4100 +1+950 +)-110)

5200= 4100+1+840

5200-4900=1

1=260 (03 Marks)

(i) Once the tax is reduced → Disposable income increases → Consumption Expenditure increases.

Therefore $\Delta C = 40 \times 0.8 = 32$.

Consumption expenditure increases by 32 billion. Hence income is also increased by the multiplier effect.

k= 1-mpc

mpc =0.8

k=1-0.8=0.2

$\Delta Y/\Delta C = k$

As $\Delta C = 32$ and k =0.2

$\Delta Y = 32/0.2 = 160$

Therefore, income expansion = ΔY = 160 billion Rs.

(02 Marks)

Once the government expenditure increases it results in increasing the total income and the expenditure directly.

Δ G increases by 40 → Δ AD increases by 40→ Δ Y increases by 40/0.2 =200

The income expansion is 200 billion rupees. (02 Marks)

Therefore the increase in the government expenditure is more expansionary. (01 Mark)

(7). (i)

- Increasing the efficient allocation of resources.
  - a) Externalities.
  - b). Welfare goods.
  - c). Public goods.
- Creating equity in income distribution.
- Reaching stability in macro economy.
- Increasing efficiency in market mechanism.
- Solving the problem of the ownership of wealth.
- Expanding infrastructure facilities.
- Regulatory functions. (05 Marks)

(ii). Public goods are defined as the goods that cannot be limited in consumption for anyone and the goods with no competition (non-rival) for consumption. (01 Mark)

Eg: National security, Lighthouses, Weather reports, Flood prevention project etc. (01 Mark)

Certain goods have a competition (rival) in consumption but the consumption cannot be restricted for anybody. (non-excludable)

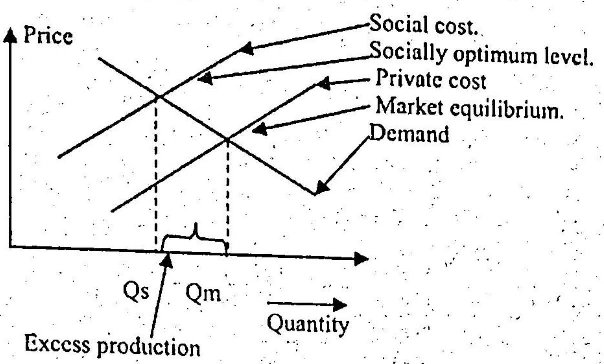
Those resources are called common resources. (01 Mark)

Eg: Marine resources, public parks and lakes, Rivers and tanks. etc. (01 Mark)

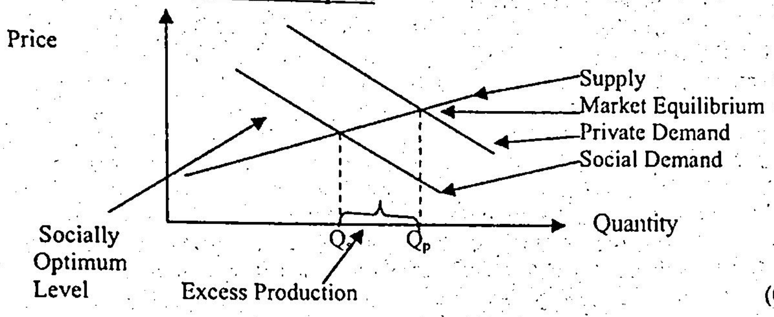
(Public goods have 2 major characteristics. They are non-rival. There is plenty for everyone, i.e. one person's consumption does not reduce the quantity available for others. E.g. a local park. They are non-excludable in price. There is no way of practical way of either charging everyone who benefits, or preventing those who do not pay from benefitting.)

(iii) (a). Negative externalities that are created by production and consumption processes lead to increasing the socially optimum output level in the market. (01 Mark)

Negative externalities in production

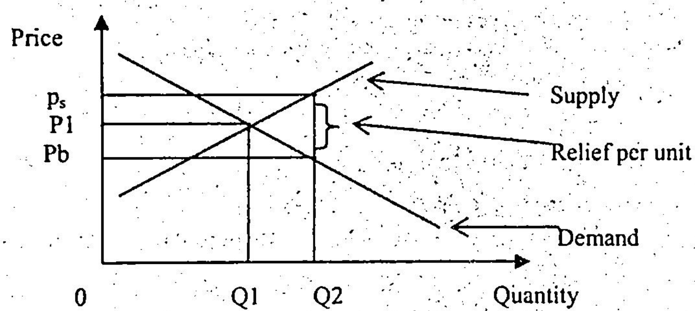


Negative externalities in consumption



(02 Marks)

(b) - There could be over allocation of resources when the government interferes into market mechanism through various policy introductions such as minimum pricing policy or production policy or production relief policies.



Here, market equilibrium is PL. But there is an excess production when the P1 is made Ps and this could be a result of certified price policy or relief policy.
Q1-Q2 shows the output being produced due to over allocation of resources. (03 Marks)

(08). (i) State owned enterprises are government institutions and corporations that function to produce and/or distribute goods and services which can be supplied by the market. (02 Marks)

(ii). - Railway Department.
- Sri Lankan Air,
- Mihin Lanka.
- Ceylon Electricity Board.
- State Engineering Corporation.
- Bank of Ceylon.
- Sri Lanka Television Corporation.
- Sri Lanka Broadcasting Corporation. (Any 5 = 05 marks)

(iii) - Unavailability of realistic policy.
- Over-recruiting of human resources.
- Difficulties in making decisions as a result of highly centralized decisions making process.
- Less accountability of the decision makers.
- Poor coordination and relationships between employers and employees.
- Poor managerial skills-Inefficiency in personnel management, financial management and production management.
- Wastes and corruption.

(iv) - An increase in total government debt. (2005= Rs. 2253.7 Billion, 2006=Rs. 2652.2 billion)

- The government debt ratio as a percentage of gross domestic product has shown a little decrease. (2005=93.9%, 2006=93.0%)
- Debt service payments in 2006 as a percentage of GDP have been increased by 28.8%. (2005=14.3% , 2006 = 15.9%).
- Less foreign grants/aids and more commercial loans from abroad.
- Increase in the amount of local and foreign loans obtained through the banking system.

(03 Marks)

2008 – ECONOMICS - II / Part –I

(1) iii	(9) i	(9) v	(13) ii	(17) iv
(2) iii	(10) iv	(10) iii	(14) iv	(18) iv
(3) ii	(11) ii	(11) iv	(15) iii	(19) iii
(4) iii	(12) v	(12) iii	(16) i	(20) iv

2008 – ECONOMICS - II / Part -II

(1) (i) (a) Demand Deposits=Liabilities
(b) Bank Office equipment = Assets
(c) Deposits with the central Bank = Assets
(d) Loans to business sector = Assets
(e) Foreign borrowings = Liabilities

(05 marks)

(ii) (a) When the full credit creation is completed the maximum possible amount of total money supply in this economy = Demand Deposits in the banking system + currency held by public
Maximum demand deposits within the banking system = (Reserves) x (1/Reserve ratio)
Reserves = 200 million Rs.
Reserve Ratio = 1/10

Maximum amount of bank deposits = $200 \times \left(\frac{1}{1/10}\right) = 2000$

Total money supply = 2000 + 1200 = 3200

(03 marks)

(b) Maximum money supply when the legal reserve ratio increases to 25%,
= Maximum demand deposits within the banking system + currency held by public

$$= 200\times\left(\frac{1}{1/4}\right)=800$$

Total money supply = 800 + 1200 = 2000 million Rs.

(02 marks)

(ii) - Increase in the net foreign assets in the Central Bank of Sri Lanka.
a) Central Bank bought foreign currency received by the government as foreign project and program aid.
b) Central Bank obtained foreign currency loans from the overseas banking units of licensed commercial banks that function in Sri Lanka.
c) Also received foreign currency loans by issuing development bonds in Sri Lanka .

(01 marks)

- Increase in the local assets in the Central Bank.
a) Central Bank has lent more money to the government.
b) Number of the treasury bills held by the Central Bank has been increased. (02 marks).

(2) (i)
- Inter-bank call money market
- Treasury bill market
- Commercial paper market
- Foreign Exchange market (Local)
- Treasury bond market.
- Securities market.
- Share market.

(05 marks)

(ii)
- Credit rating is an estimate of the amount of credit that can be extended to a company or person without undue risk. (In other words it is an assessment of the credit worthiness of individuals and corporations. It is based upon the history of borrowing and repayment, as well as the availability of assets and liabilities. Credit is important since individuals and corporations with poor credit will have difficulty finding financing, and will most likely to have to pay more due to the risk of default).
- Common criteria are used in the process of credit rating. E.g. Investment Rate = AAA-BBB = The probability for non-settling a debt in this rate is very low, Non-investment rate = B-D = the above probability in this rate is very high.
- The following three institutions hold the reputation for international credit rating.

a) Moody's
b) Standard and Poor's
c) Fitch Ratings.

(02 Marks)

- Credit rating estimates the financial credibility and the sustainability of the firm as it is based upon the financial history and current assets and liabilities.
- The Central Bank has instructed all the financial institutions that they should take rates from an approved credit rating institute and also should publish them for the knowledge of the general public.

(02 Marks)

(iii) - Policy interest rates of the Central Bank are the interest rates used by the Central Bank in implementing its monetary policy. There are three interest rates used as policy interest rates.
a) Repo rate
b) Reverse Repo Rate
c) Bank Rate.

(02 Marks)

(iv) When the policy interest rates are changed it changes the structure of interest rates in the economy Once the policy interest rates are increased it results in an increase of interest rate in the money market and vice versa.
- When the policy interest rates are changed, then the changes occur in interest sensitive expenditure components of the total economy. E.g. Private investments, leasing and hire purchasing.
- Changes in interest rates create changes in prices of assets. There is a direct relationship between interest rate and price of assets.
- Interest rates affect on total income and expenditure through the influence made on aggregate demand components. (04 Marks)

(03). (i) Inflation is defined as the persistent increase in the general price level. (01 Mark)
- Deflation is defined as the persistent decrease in the general price level. (01 Mark)
- Disinflation is defined as the gradual reduction of the inflation rate. (01 Mark).

(ii) - Colombo Consumer Price Index.
- Colombo Consumer Price Index (New)
- Stock Price Index
- Colombo District Consumer Price Index
- Sri Lanka Consumer Price Index
- GDP Deflator. (04 Marks)

(iii) Does not reflect on consumer's real changes in market behaviour.
- Outdated methods.
- Base year (1952).
- New goods and services are not counted in the index.
- Index is too sensitive for prices of certain goods.
- Geographically limited to Colombo district.
- Only the middle class in Colombo is represented by the index.
- Only the prices of consumer goods are reflected. (04 Marks)

(iv) - Unequal distribution of income.
- Lenders are at disadvantage while borrowers are benefited.
- Inflation may puzzle the economic decision making process.

- Due to the uncertainty of the future behaviour of prices people may only invest in short term investment projects instead of long term ones.
- Shoe leather cost and Menu cost.
- Export competition is distracted and the current account is badly affected.
- Depreciations in the exchange rates.
- Labour unions may create instability.
- Absolute poverty may be increased. (04 Marks).

(4) (i) Indonesia. (01 Mark)
- The opportunity cost of a TV in Indonesia is less than that of Philippines.

Indonesia	Philippines
12 TVs = 24 Radios	4 TVs = 16 Radios
1 TV = Radios	1 TV = 4 Radios

(01 Mark)

(ii) Rate of exchange

Indonesia	Philippines
1 TV = 2 Radios 1 Radios = ½ TV	1TV = 4 Radios 1 Radios = ¼ TV

(01 Mark)

Mutually beneficial rate of exchange

1 TV = 2< Radio < 4

a. Radio = ¼ < TV ½

b.

(iii)- Utilizing resources taken from the capital and the financial account.

- Implementing protectionist policies.
- Higher tariff on imports.
- Restricting imports.
- Government intervention in export promotion.
- Multi-lateral and bi-lateral trade agreement.
- Diverting resources from import sector to export sector.
- Devaluation of the exchange rate. (Value depreciation). (05 Marks)

(iv)- Advantages:

- Instead of trying to protect external stability it is possible to achieve internal stability through fiscal and monetary policy implementations independently.
- Monetary policy can be implemented independently without external forces.
- Needless to retain huge amount of official exchange reserves. Those resources can be utilized in some other useful function.
- It is important to have a realistic exchange rate system in order to allocate world resources among competitive uses.

Advantages

- It is disadvantageous to have exchange rate fluctuations and uncertainty about them for a better investment and trade.
- As a result of fluctuations of exchange rates, foreign exchange market may become unstable.
- The idea that there should be a certain discipline in financial control in order to reduce the inflation is highlighted. (05 Marks)

Section-B

(5) (i)

- Economic growth shows the persistent increase in the real output of a country. (01 Mark)
- It is a continuous process that broaden the production capacity of a country in order to increase its real output. (01 Mark)
- Economic development is a process that improves the standard of living of all the people in the **country**.
- In the development process, it is important to build a healthy economic, political and social environment that is meant for the development of the standard of living and the self esteem of every citizen in the country. (Increasing income, consumption, health and education). (01 Mark)

(ii) Strengths

- It is a useful measure that has been designed to broaden our knowledge about the components of **development** and the countries that succeeded at achieving development.
- This index has considered the important contributory factors to the development such as literacy rate, level of education, life span, health and the other related social factors.
- Limitations reflected by narrow measurements like per capita income have been overcome by this index.
- All the countries in the world can be categorized using this index according to their level of development. (High, medium or low level of human development). (02 Marks)

Weaknesses

- Since this is an aggregate measure, it does not reflect the development discrepancies incurred inside the country. E.g. Distribution of income, provincial development. etc.
- This index does not consider each and every aspect of human development. E.g. Participation, Political freedom, human security and so on.
- Qualitative changes are not considered. E.g. quality of the school education, qualitative changes in health facilities.
- Each component of the index has been weighted equally regardless of its importance.
- Education considers only the number of enrolment to the primary section and does not take into account the dropouts.
- Environmental aspect is reflected through this index. (02 Marks)

(iii) - **Sustainable development** is a pattern of resource use that aims to meet human needs while preserving the environment so that these needs can be met not only in the present, but also for future generations to come. It is the development that "meets the needs of the present without compromising the ability of future generations to meet their own needs". (01 Mark)

- Sustainable development can be achieved by having the balance among the sectors such as economic, social and environment of the country. If one of the above sectors is undervalued then the set objective is not met. (02 Marks)

(iv)
- Physical capital.
- Human capital.
- Natural capital.
- Social capital. (04 Marks)

(06) (i) (a) The labour force participation rate in Sri Lanka is defined as the ratio between employed plus unemployed population above the age 10 years and the total population above the age 10 years, within a given period of time. Or

$$\frac{\textit{Employed population above 10 + Unemployed population above 10}}{\textit{Total Population above 10 years}} \times 100$$ (02 Marks)

(b)
- Male participation rate in Sri Lanka in 2006 = 68.1% (68%) (01 Mark)
- Female participation rate in Sri Lanka in 2006=35.7 %(36%) (01 Mark)

(ii) (a)
- Informal economy comprises of the economic functions of the poor communities who receive no formal reputation, direction or support from the government in that country.
- Informal economy has been originated as a result of using the labour of one's own family to produce goods and services, unwillingness to pay or contribute to taxes and social security systems or to be governed by rules and regulations of the existing government.
- E.g. Self employment carry on at their own house, selling goods on pavements or public paths, offering unskilled labour to householders on daily basis. (03 Marks)

(b)
- Informal economy in Sri Lanka consists of people and small production units that produce goods and services using relatively small capital and their own labour.
- An important role is played in the informal economy in Sri Lanka especially in the sectors such as local agriculture production, hand craft production, building construction industry, mining industry and transport.
- The contribution made by the informal sector of Sri Lanka to its GDP is estimated as 40%-45%.
- Also it contributes to more than 63% of the total employment in Sri Lanka. However, 84% of the employment in informal economy is dominated by the agricultural sector in Sri Lanka. (04 Marks)

(iii)
- Economic pressure on the labour force is increased as a result of the increase in the adult dependency ratio. Savings and investments may be decreased due to that and then the future level of standard of living may be badly affected.
- Contribution to social security funds is increased. Due to this the government funds that can be used for economic development of the country is limited. As a result of this, the future economic growth can be challenged.
- Internal migrating (people migrating from rural areas to urban areas), more nuclear family units that are created instead of extended families thus making it impossible to look after the aged within the extended family units as done in the past have made unfavourable effects on ageing population.
- It has been predicted that the standard of living of aged female population may be worsen compared to that of the aged male population in the future.
- Reasons for this trend have been given as lower literacy rate among women, lower rate of labour force participation, legal restrictions over women's right to own wealth and generally low economic level of Sri Lankan women. (04 Marks)

(07) (i)
- Emerging market economies are defined as economies that are progressing toward the development by restructuring the whole economy and improving trade, technology and direct foreign investments. E.g. China, India, Indonesia, Brazil, Russia, Mexico, Argentina, South Africa, Poland and Turkey. (02 Marks)

<u>Main features</u>

- Economically strong within the region. Strength has been created through population, resource endowment and expanding market.
- These countries have introduced open economic policies broadening their economic and political structures instead of going back to the highly restricted and centrally planned economic policies that did not succeed at one time in the past.

- These countries have contributed to the improvement in world trade massively while reporting a substantial economic growth.
- Also they have been able to contribute to the world politics in making important decisions that have made an impact on their economic, social and political development.

(Emerging markets generally do not have the level of market efficiency and strict standards in accounting and securities regulation to be on par with advance economies but emerging markets will typically have a physical financial infrastructure including banks, a stock exchange and a unified currency.

Emerging markets are sought by investors for the prospect of high returns, as they often experience faster economic growth as measured by GDP. Investments in emerging markets come with much greater risks due to political instability, domestic infrastructure problems, currency volatility and limited equity opportunities (many large companies may still be "state-run" or private). Also, local stock exchanges may not offer liquid markets for outside investors). (03 Marks)

(ii)- Resource endowment. (Physical, human and natural capital). (01 Mark)
- Technical knowledge.
- Novelty
- Tax system
- Regulations
- Free trade
- Improvements in the financial system.
- Employer-employee relationship.
- Infrastructure facilities. (04 Marks)

(iii) Increasing the output, productivity and the competition in agricultural sector based on exports. (02 Marks)
- Giving a huge benefit for the production factors such as land, labour and capital that are utilized in the agricultural sector.
- Increasing the productivity through the exchange of technology.
- Introducing a commercial base for small and medium scale production functions. (03 Marks)

(08) (i) - External stability indicates that the country maintains a strong balance of payment and a stable exchange rate. (02 Marks)

(ii) - The balance in the current account has increased dramatically. Current account deficit as a percentage of the gross domestic product is given below.

2005	2.8%
2006	4.9%

- The deficit in the Balance of Trade has also increased. Balance of Trade deficit as a percentage of GDP is given below.

2005	10.7%
2006	12.5%

- The deficit in the income account has also increased. Increased interest rates for foreign loans and increased dividends of the remittance made by the foreign investors are the reasons for this trend.
- Private transfers have increased too due to the remittance of the migrants. (03 Marks)

(iii) - Increase in the import prices.
- Devaluation of the US $ compared to the other currencies.
- Depreciation of the face value of the Sri Lankan rupee.
- Economic recession in the developed, western countries like USA. (05 Marks)

(iv) - Despite widening trade deficits, the overall balance of the Balance of Payment has shown a surplus in the recent years as the net receipts of Capital and Financial account has surpassed the current account deficit. (02 Marks)
- Direct foreign investments have increased.
- Foreign capital flow received as aid and loan by Sri Lanka has increased.
- Government has borrowed from the International Monetary Fund.
- Short Term Capital that was flown into the country has increased.
- Foreign currency loans supplied to the domestic sector by the commercial banks have increased.
- Investments in Sri Lanka Developments Bonds. (03 Marks)