SRI LANKA

Association of Accounting Technicians of Sri Lanka

January 2017 Examination - AA1 Level

Questions and Suggested Answers
(AA 13)

ECONOMICS FOR BUSINESS & ACCOUNTING
(EBA)

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A publication of the Education and Training Division

THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

EDUCATION AND TRAINING DIVISION

AA1 Examination - January 2017
(AA 13) Economics for Business & Accounting

SUGGESTED ANSWERS

SECTION – A

Objective Test Questions (OTQs)

Twenty (20) compulsory questions.

(Total 40 marks)

Suggested Answers to Question One:

Question No	Answer
1.1	2
1.2	3
1.3	1
1.4	4
1.5	4
1.6	2
1.7	2
1.8	2
1.9	2
1.10	3
1.11	TRUE
1.12	FALSE
1.13	TRUE
1.14	FALSE
1.15	FALSE
1.16	Utility
1.17	Producers
1.18	Fiscal Policy
1.19	Comparative Advantage
1.20	Decreasing Returns to Scale

End of Section A

SECTION –B

Four (04) compulsory questions
(Total 40 marks)

Suggested Answers to Question Two:

(a)

i. The main economic resources of an economy can be listed out as follows,

- Land (Natural resources)
- Labour (Physical and mental abilities of human being)
- Capital (Man-made resources)
- Entrepreneurship. ***(02 Marks)***

ii. Opportunity Cost refers to the value of the next best alternative forgone of an economic activity as a selection of an opportunity due to scarcity of resources and alternative uses of resources. Opportunity cost is a real concept which may or may not include monetary value in the decision making. It is the main cost which is taken into account in the decision making in economics.

Example; If a person has commenced owned business by using his labour, capital and other assets , the opportunity cost of this business is the returns, incomes or benefits that could have been earned from his labour , invested capital and other assets by utilizing them elsewhere in other opportunities. ***(03 Marks)***

(b) **Characteristics of Market economic system**

- All resources are directly or indirectly owned by the private sector and there is no government sector involvement (private property ownership)
- Market mechanism or price mechanism is used to solve the basic economic problems resources allocation.
- High degree of freedom of choice (Consumers and producers have freedom or sovereignty in decision making)
- Availability of competitive markets
- Environment will be neglected by the private sector (External cost)
- Existence of an income distribution disparity.
- Prices of commodities are determined through market force by the interaction of demand and supply.

(05 Marks)
(Total 10 Marks)

Suggested Answers to Question Three:

(a)

i.
- Central Bank
- Licensed Commercial Banks
- Licensed Specialist Banks
- Finance Companies
- Leasing Companies
- Financial Intermediaries

(02 Marks)

(b)

i. "Monetary policy" refers to the action taken by the monetary authorities to change quantity / availability (money supply) and Cost of money (interest rate), it includes the actions taken by central bank or monetary authorities of an economy to control money supply and interest rate of the economy.

Monetary policy is formulated and implemented for the purpose of achieving macroeconomic goals. It includes both quantitative controls and qualitative controls.

(04 Marks)

ii.
- Open market Operations
- Statutory Reserve Ratio
- Bank Rate policy
- Moral suasion
- Fixing maturity periods for commercial bank credit
- Portfolio ceilings
- Provision for refinancing facilities
- Fixing selective interest rates

(04 Marks)

(Total 10 Marks)

Suggested Answers to Question Four:

(a)

The money supply is the entire stock of currency and other liquid instruments held by general public in an economy to exchange goods and services at a particular time (point of time) . The money supply can include cash, coins and balances held in various deposit accounts. Money supply includes only money held by public.

The Central Bank controls the supply of money and that interact with other financial institution.

- Money supply includes different form of money such as currency, demand deposit, time and saving deposits held by the public at different institutions such as commercial banks and other financial institutions.
- Money supply is more important to determine the interest rate and macroeconomic policies.

(03 Marks)

(b)

i. Main causes of inflation are stated below,
   - Demand pull inflation (increase in aggregate demand)
   - Cost of inflation (increase in cost / decrease in aggregate supply)

(02 Marks)

ii. Economic consequences of an increase in inflation.
   - Real income and purchasing power of people (fixed income earners and low income earners) decrease and standard of living declines.
   - If the price of goods and services within the country increase too much then people and business may start to import more goods from abroad because they are cheaper , as a result Balance of Payment will adversely be affected.
   - Production within the country will be discouraged and the economy will not be able to achieve an economic growth. .
   - Workers and trade unions will demand for increasing their salaries. This will cause problems at work.
   - When the production decreased in the country, there will be a reduction in employment and as a result unemployment rate will increase in the economy.
   - The cost of business may increase and investment will decrease.

(05 Marks)

(Total 10 Marks)

Suggested Answers to Question Five:

(a)

i. **Gross Domestic Product (GDP) at Market Price** **(Rs. Million)**

Gross Domestic Product (GDP) at factor cost prices	=	3,250
Add: Indirect taxes	=	175
Less: Subsidies	=	(125)
Gross Domestic Product (GDP) at Market Price		**3,300**

(03 Marks)

ii. **Gross National Product (GNP) at Market Price.**

		(Rs. Million)
Gross Domestic Product (GDP) at market prices	=	3,300
Add: Net Factor Income from Abroad	=	250
Gross National Product (GNP) at Market Price		**3,550**

(02 Marks)

iii. **Net National Product (NNP) at Market Price.**

		(Rs. Million)
Gross National Product (GNP) at Market Price.	=	3,550
Less: Capital Depreciation	=	(150)
Net National Product (NNP) at Market Price		**3,400**

(01 Mark)

(b)

Key macroeconomic objectives are follows,

- High and sustainable economic growth
- Low and stable inflation
- Full Employment
- Balance of Payment equilibrium

(04 Marks)

(Total 10 Marks)

End of Section B

SECTION –C

A compulsory question.
(Total 20 marks)

Suggested Answers to Question Six:

A. a.

i. Short-run production refers to the production process in which goods and services are produced by using both fixed and variable factors of production or inputs. A firm engaged in production in the short run increases its output by increasing the use of variable factors such as raw materials and labour while fixed factors such as buildings, machinery and technology etc... remain constant. Under the short run at least one factor of production is fixed.

Long-run is a period of time in which a firm able to change all inputs. The firm will increase its output by increasing all the factors. In other words this will be a change in scale or the sale of the firm. Under the long run all factors of production are varied.

(04 Marks)

ii.

In the short run, a firm under perfect competition cannot increase its scale of production and new firms cannot enter into the industry. Therefore, prices remain unchanged in the short run.

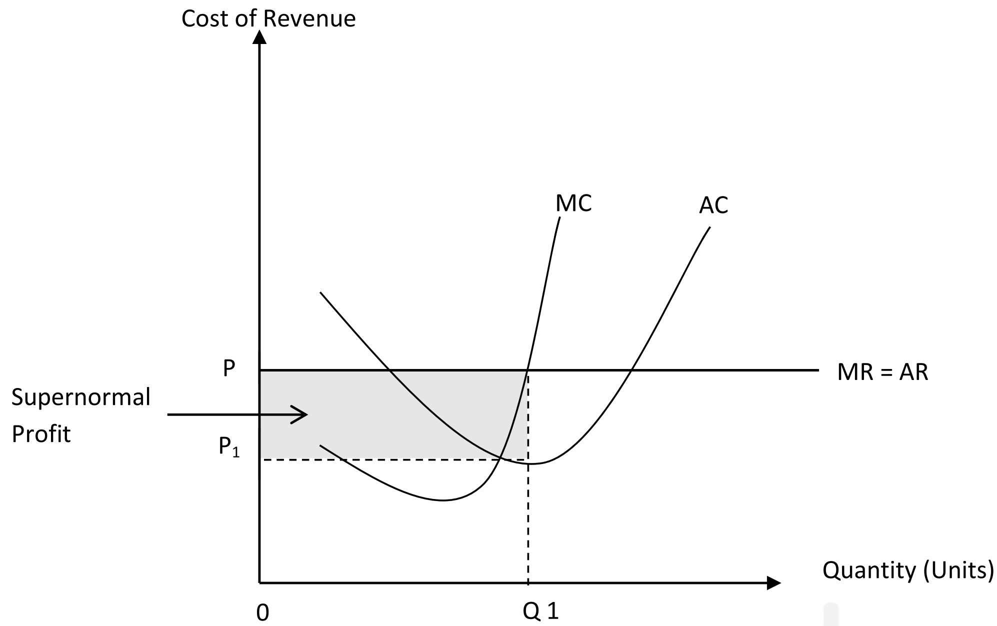
Hence, the firm earns supernorminal profits by maximizing its profits.

Profits maximize when the costs of producing of an extra unit of output (MC). Equals to the extra revenue generated by selling that extra unit of output (MR).

This is at the point where,

MR = MC

Perfectly competitive frim sells all its outputs at the same price which is its average revenue (AR). Hence, the marginal revenue (MR) is equal to the price (P) of the product and the AR, hence, the demand curve faces horizontal.



Profit maximizing output level is Q1 where MC=MR

(05 Marks)

b. i.

Qd	=	2,800 - 25p
Qs	=	-200 + 100p
Qd	=	Qs at the equilibrium
2,800 - 25p	=	-200 + 100p
3,000	=	125p
3000/125	=	p
24	=	P

Equilibrium Price – Rs. 24/- ***(03 Marks)***

ii.

P	=	24 is substituted to the Qd equation,
Qd	=	2,800 - 25p
Qd	=	2,800 - (25 x 24)
Qd	=	2,800 - 600
Qd	=	2,200
Qs	=	-200 + 100p
Qs	=	-200 + 100 x 24
Qs	=	2,200

Equilibrium quantity is 2,200 units ***(02 Marks)***

B. **Advantages of International Trade.**

- **Increased production**

  Free trade permits countries to specialize in the production of those commodities in which they have a comparative advantage. With specialization countries are able to take advantage of efficiencies generated from economies of scale and increase in output.

- **Maximum utilization of resources**

  International trade helps a country to utilize its resources to the maximum limit. If a country does not take up imports and exports then some of its resources may not be utilized. Thus it helps to eliminate the wastage of resources.

- **Benefits to consumers**

  Consumers are benefited by using high quality goods and services through international trade.

- **Promote international relationship**

  International trade fosters peace, goodwill and mutual understanding among nations. Economic interdependence of countries often leads to close cultural relationship.

- **Reduce trade fluctuations**

  By making the size of the market large with the large suppliers and extensive demand international trade reduces trade fluctuations.

(06 Marks)

(Total 20 Marks)

End of Section C

Notice :

These answers complied and issued by the Education and Training Division of AAT Sri Lanka constitute part and parcel of study material for AAT students.

These should be understood as Suggested Answers to question set at AAT Examinations and should not be construed as the "Only" answers, or, for that matter even as "Model Answers".

The fundamental objective of this publication is to add completeness to its series of study texts, designs especially for the benefit of those students who are engaged in self-studies. These are intended to assist them with the exploration of the relevant subject matter and further enhance their understanding as well as stay relevant in the art of answering questions at examination level.