



Association of Accounting Technicians of Sri Lanka

AA1 Examination - January 2019

**Questions and Suggested Answers
Subject No : AA13**

**ECONOMICS FOR BUSINESS & ACCOUNTING
(EBA)**

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

EDUCATION AND TRAINING DIVISION

**AA1 Examination - January 2019
(AA13) Economics for Business & Accounting**

SUGGESTED ANSWERS

SECTION – A

Objective Test Questions (OTQs)

Twenty (20) compulsory questions.

(Total 40 marks)

Suggested Answers to Question 01:

Question No	Answer
1.1	4
1.2	2
1.3	4
1.4	4
1.5	2
1.6	3
1.7	4
1.8	1
1.9	4
1.10	1
1.11	FALSE
1.12	TRUE
1.13	FALSE
1.14	TRUE
1.15	TRUE
1.16	Mixed economy
1.17	Monopolistic competition
1.18	Public goods
1.19	Floating
1.20	Financial intermediation

(02 marks each, Total 40 marks)

End of Section A

Four (04) compulsory questions
(Total 40 marks)

Suggested Answers to Question 02:

Unit -02 consumer behavior and the Market

(a)

i.

$$\begin{aligned} Q_d &= 200 - 2p \\ Q_s &= -40 + 6p \\ \underline{Q_d} &= \underline{Q_s \text{ at the equilibrium level}} \end{aligned}$$

$$\begin{aligned} 200 - 2p &= -40 + 6p \\ 240 &= 8p \\ 240/8 &= p \\ 30 &= P \end{aligned}$$

$$\underline{\underline{\text{Equilibrium Price} = \text{Rs. 30/-}}}$$

ii.

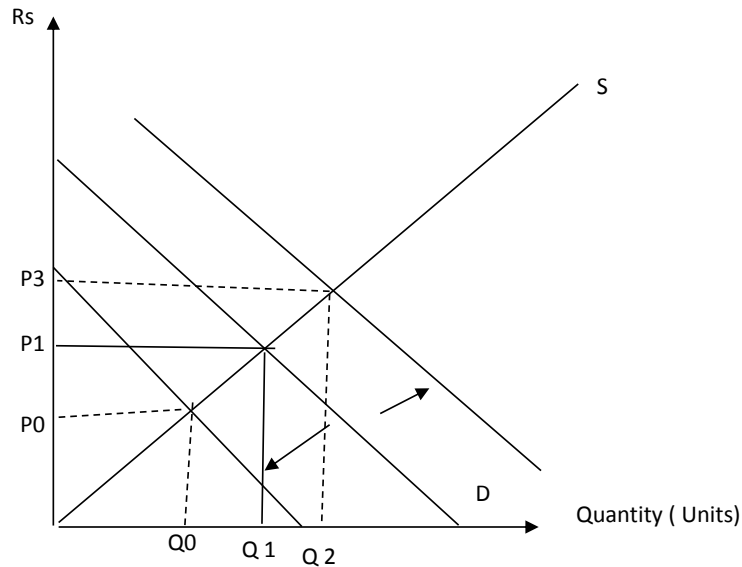
$$\begin{aligned} P &= 30 \text{ is substituted to the Qd equation,} \\ Q_d &= 200 - 2p \\ Q_d &= 200 - (2 \times 30) \\ Q_d &= 200 - 60 \\ Q_d &= 140 \end{aligned}$$

$$\underline{\underline{\text{Equilibrium Quantity} = 140 \text{ Units}}}$$

iii.

When the consumer's taste moves away, demand for the product would decrease. Demand curve will shift to left as a result.

This will reduce both equilibrium price and quantity as follows;



(03 marks)

(b) **Price elasticity of demand is determined by the following factors**

- Availability of close substitutes
- Nature of the good (Whether the good is a luxury or a necessity)
- Share of consumer's budget (percentage of income allocated for the product)
- Passage of time (Time Factor)
- Habit forming goods
- Number of necessities / uses
- Definition of the commodity
- Ability of alternative uses

(03 marks)

(Total 10 marks)

Suggested Answers to Question 03:

Unit 03 - Production and Costs

(a) Shutdown production level is the production level at which the business firm leaves the industry or the production level at which the business firm shutdown its business activities. Following condition should be satisfied at this production level. This production level helps to determine the minimum price of a product.

$$\text{Average Variable Cost} = \text{Price (Average Revenue)}$$

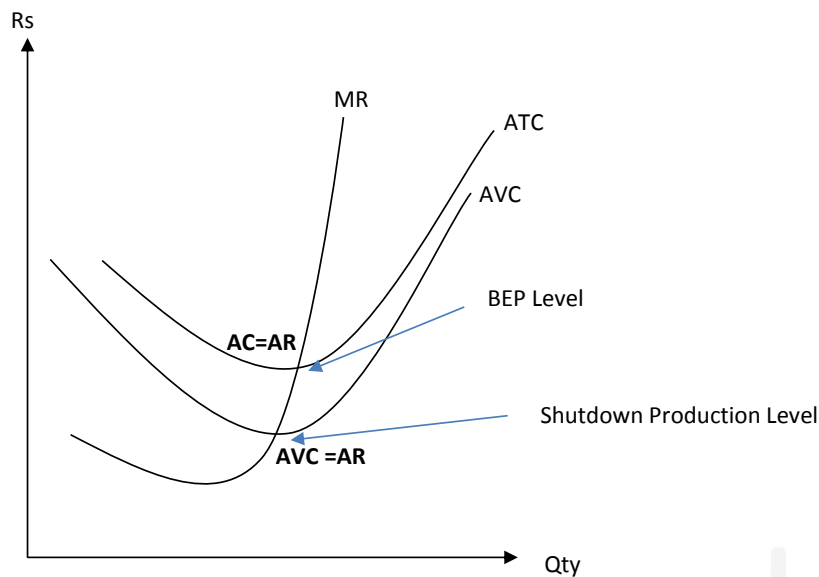
Break-even production level is the production level at which the business firm makes no loss or profit where total cost is equal to the total revenue. Following conditions are satisfied at this production level. Firm is able to recover total cost at this production level.

$$\text{Total Revenue (TR)} = \text{Total Cost (TC)}$$

$$\text{Average Revenue (AR)} = \text{Average Cost (AC)}$$

$$\text{Average total cost} = \text{Price}$$

revenue (AR) = Average Cost (AC)



(06 marks)

(b)

Unit 06 - Banking and Monetary Policy
--

- i. Functions of commercial banks can be stated as follows,
- Accepting deposits from public such as savings and current accounts.
 - Lending money in the form of loans or overdrafts.
 - Banks provide a payment mechanism, whereby individuals, firms and government can make payments to each other.
 - Provide a place for individuals, firms and government to store their wealth.
 - Providing safety vaults for individuals to safeguard jewellery and other valuables
 - Advising and assisting individuals and companies on investment matters.
 - Provide assistance for exporters and importers by operating letters of credit.
 - Facilitating foreign currency transactions.
 - Debt factoring services

(03 marks)

- ii. Examples for license commercial banks in Sri Lanka,

- | | |
|---------------------------|------------------------|
| - Bank of Ceylon | - People's Bank |
| - Commercial Bank | - Hatton national bank |
| - Sampath Bank | - Nations Trust bank |
| - Seylan Bank | - Pan Asia Bank |
| - NDB Bank | - HSBC Bank |
| - Standard Chartered Bank | |

(01 mark)

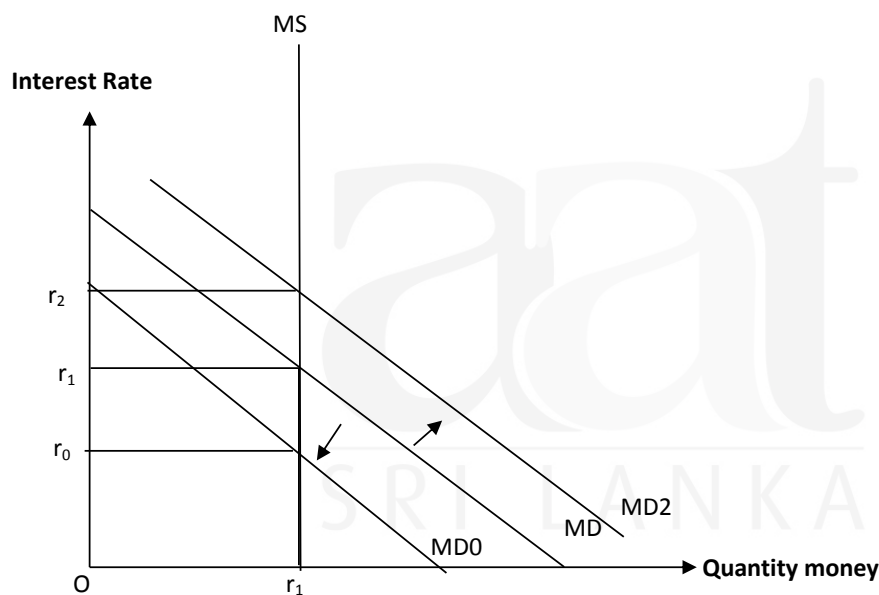
(Total 10 marks)

Suggested Answers to Question 04:

Unit 05 - Money and price level
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- (a) Demand for money is the interest or preference that people have to hold money in the form of currency. Total demand for money is determined by various factors such as national income, interest rate and price level etc. demand for money is one of the two forces which affect the determination of interest rate in the economy.

When demand for money increases due to various reasons such as increase in national income of the economy, the demand curve shifts to the right and interest rate increases while supply of money remains unchanged. If demand for money decreases interest rate also decreases when all other factors remain constant.



(06 marks)

- (b) Demand pull inflation refers to the increase in general price level of the economy due to increase in demand for goods and services over the supply of goods and services in a given period. Demand pull inflation is caused by increase in money supply, increase in private and government expenditure, increase in export income of an economy etc..

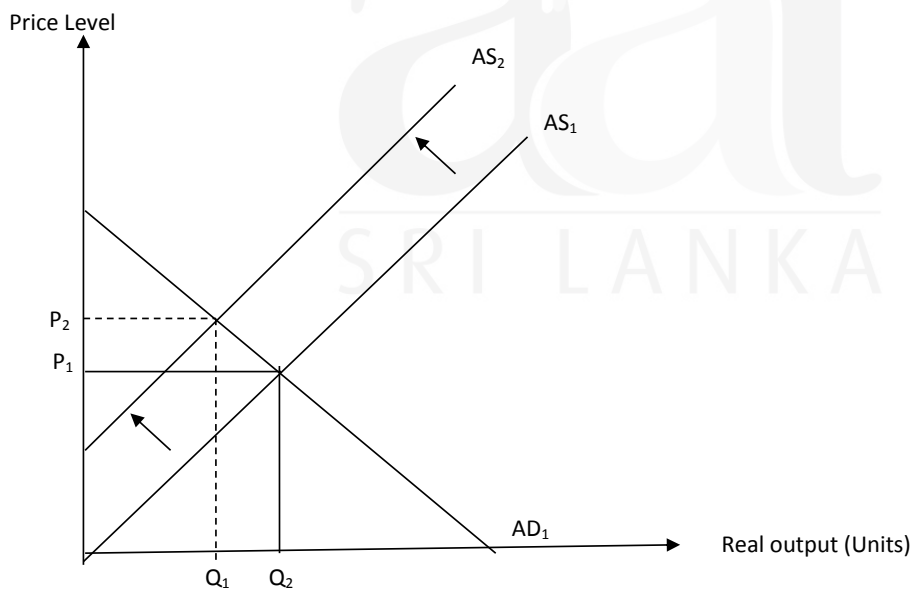
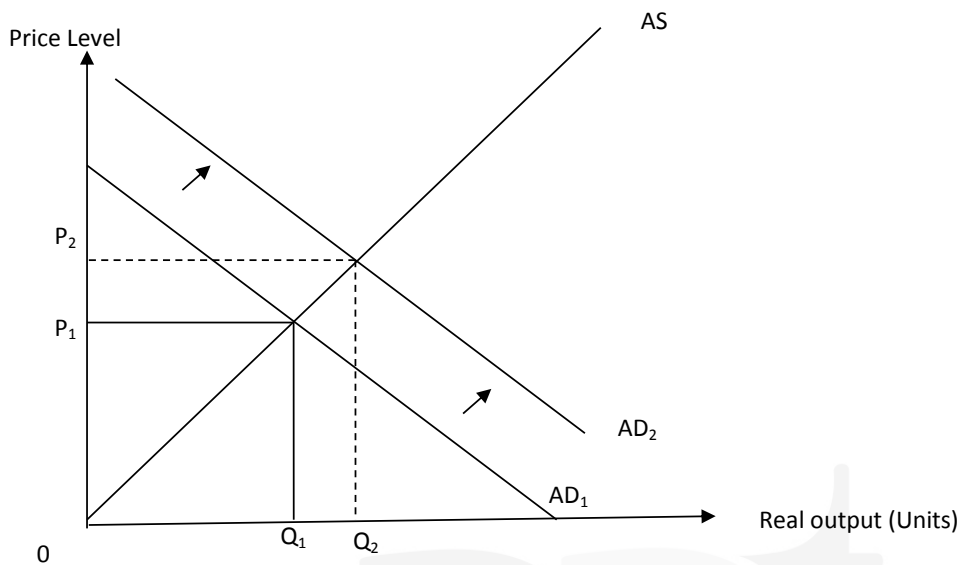
Demand pull inflation occurs when total demand for goods and services exceeds total supply. This type of inflation happens when there has been excessive growth in aggregate demand and there is an inflationary gap.

Cost push inflation occurs when firms increase prices to maintain or protect profit margin after experiencing a rise in their cost of production and it is usually the result of increase in the cost of production.

Cost push inflation originates from the supply side and it is an increase in price level of the economy due to increase in cost of production and decrease in aggregate supply in the given period. Some of the reasons for cost push inflation are,

- Increase in wage rate of the economy

- Increase in interest rate of the economy
- Increase in raw material prices and other input prices
- Increase in import prices



(04 marks)
(Total 10 marks)

Suggested Answers to Question 05:

(a)

Unit 05 - Money and Price Level

Open market operations refer to the purchase and sale of treasury bills by the central bank in the open market.

If the objective is to reduce the money supply, treasury bill will be sold in the open market. The

buyers pay for these securities through cheques drawn on their current accounts in the commercial banks. It will reduce the ability of commercial banks to create credit.

On the other hand, when it is necessary to increase the money supply, the central bank will repurchase the securities so that there will be a flow of money from the central bank to the public and increase in the money supply.

(04 marks)

(b)

Unit 08 - International Trade

Disadvantages of protectionism can be stated as follows,

- Prevent countries enjoying the full benefits of international specialization and trade
- Protect inefficient home industries from foreign competition and as a result consumers pay more for inferior products.
- Trade barriers increase the cost of trading
- A barrier for export and imports and a reason for decreasing standard of living in the country.
- Sacrificing welfare benefits
- Promoting unequal and unfair allocation of resources.
- Invite retaliation from foreign governments. If an economy puts up trade barriers then other countries are likely to retaliate.
- Protectionism keeps the firms of an economy away from genuine competition. They may become lazy and inefficient.
- Free trade forces local firms to produce quality goods and services as they face much foreign competition. Cost of production will increase.
- Free trade encourages firms to export and import. This should encourage a greater choice for consumers and it will affect to increase the cost of living.

(02 marks)

(c)

Unit 08 - International Trade

- Increase in imports to the country
Imports of all kinds of goods to the country would increase during this period. As a result, demand for foreign currency would increase.
- Withdrawn of foreign investment from the country and low investments inflows to the country.
Because of the political and economic reasons, lot of foreign investors have left our country and as a result our currency has been devalued.
- Low export growth: When export income decreases foreign currency supply reduces and currency is devalued.
- Low level of foreign reserves and high debts and debt settlement.

(06 marks)

(Total 10 marks)

End of Section B

A compulsory question.

(Total 20 marks)

Suggested Answers to Question 06:

A)

Unit 04 - Role of the Government within a Market System

(a)

Advantages of public enterprises are given below.

- The main objective of a public enterprise is to provide a service and not make profits; therefore it will help to improve social welfare.
- The profits earned by public enterprises will be added to the government revenue since it doesn't belong to any individual. These profits can be used for social welfare.
- Government has the capacity to launch large scale development projects.
- Public enterprises can obtain the services of the experts in the relevant field and therefore, efficiency can be enhanced.
- The misconduct of public enterprises can be revealed through the representatives of the public.
- Security of employments is guaranteed.

(02 marks)

(b) **The main objectives of the government budget can be stated as follows,**

- Efficient allocation of limited resources
- Redistribution of income
- Promotion of economic growth and development
- Provision of economic stability
- Maintaining the economic stability

(04 marks)

B.

Unit 07 - Macroeconomy and Business Environment

(a)

Gross Value Added (GVA) at basic price.

	<i>(Rs. Millions)</i>
Compensation for employees	2,000
Net operating surplus	1,000
Mixed income	1,100
Other taxes less subsidies on production	750
Gross Value Added (GVA) at basic price.	4,850

(b)	Gross Domestic Product (GDP) at market price.	
	Gross Value Added (GVA) at basic price.	4,850
	Indirect Taxes	150
	Gross Domestic Product (GDP) at market price.	5,000
(c)	Gross National Income (GNI).	
	Gross Domestic Product (GDP) at market price.	5,000
	Net Foreign Primary Income	1,200
	Gross National Income (GNI).	6,200
(d)	Gross National Disposable Income (GNDI).	
	Gross National Income (GNI).	6,200
	Net Foreign Current Transfers	550
	Gross National Disposable Income (GNDI).	6,750

(10 marks)

(C)

Unit 09 - Economic Growth and Development
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(a) **Economic Growth**

Economic growth refers to the expansion of an economy's production possibility of potential output of the economy over time. That is the increase in real GDP of an economy continuously over time. Economic growth results a shift in production possibility curve to the right.

Following factors contribute in the economic growth of an economy (any four factors)

- Increase in resources endowment
- Increase in productivity
- Macro economic stability (Control over the inflation)
- Availability of favorable incentive system in the economy
- Skill developments of entrepreneurs
- Good governance
- Political stability

(b) **Economic Development**

Economic development is the process of improvement in quantity and quality of production of an economy over time. Economic growth is not the only requirement in the development process, improvement in social, cultural and other structural changes are required with the economic growth to meet the economic development.

(04 marks)

(Total 20 marks)

End of Section C

Notice :

These answers compiled 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.

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