



Association of Accounting Technicians of Sri Lanka

July 2019 Examination – AA1 Level

**Suggested Answers
Subject No : (AA13)**

**Economics for Business and
Accounting (EBA)**

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A publication of the Education and Training Division

THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA
AA1 Examination – July 2019
(AA13) Economics for Business and Accounting
SUGGESTED ANSWERS

Twenty (20) compulsory questions
(Total 40 marks)

SECTION - A

Suggested Answer to Question 01:

Question	
1.1	2
1.2	4
1.3	2
1.4	1
1.5	1
1.6	3
1.7	1
1.8	2
1.9	4
1.10	4
1.11	True
1.12	False
1.13	True
1.14	False
1.15	True
1.16	Negative/an inverse
1.17	Maximum
1.18	Decrease
1.19	Capital
1.20	Technological Development

(02 marks each, Total 40 marks)

End of the Section-A

Suggested Answers to Question 02:

Chapter 01- introduction to Business Economics

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

- (1) Land (Natural resources)
- (2) Labour (Physical and mental abilities of human being)
- (3) Capital (Man-made resources)
- (4) Entrepreneurship.

(02 marks)

ii. (1) **Land**

Land is defined as all-natural resources used in the production process. Natural resources are sub-divided into renewable and non-renewal resources. Continuous use leads to the depletion of certain types of natural resources. Land is an essential element in the production process. Land includes all resources given by the nature to produce goods and services. Price of land is known as rent.

Examples: The atmosphere, ocean, rivers and lakes, forest and mineral, oil wildlife and fish etc....

(2) **Labour**

Labour is defined as the physical and mental abilities of the human being used in the production activities. Labour can be improved through education and training. These abilities cannot be detached from a person. The price of labour is known as wages.

Examples: Physical abilities of workers, mental abilities of teachers and both physical and mental abilities of technicians.

(3) **Capital**

Capital is the man-made resources used in the production activities to produce goods and services. These are supportive factors in the production process. The term capital, in day to day business refers to money or monetary value of assets.

Examples: Buildings, machinery, motor vehicles, roads and airports etc. the rewards for capital is known as interest.

(4) Entrepreneurship

This is the factor which purchases all other factors of production and organizes production process by taking a risk of the production activity. The rewards for entrepreneurship is known as normal profit. The creative ability of individual to produce new or already existing product to earn a profit is known as entrepreneurship. Reward paid for entrepreneurship is known as “Profit”

(02 marks)

(b) ii. What to produce? (Allocation problem).

What to produce refers to those goods and services and the quantity of each that the economy should produce. It is a problem allocation of scarce resources which have alternative uses of resources among the various economic activities. This problem is common to all societies.

Market economy: This is solved based on the commodity price by the price mechanism which is guided by demand for goods and services. Private produces choose high price product and produce more quantities from high product and less quantities from low price product.

Planned Economy: This problem is solved based on the central planned by the panning authority. According to the social requirement they decide what and how much to produce.

How to produce?

How to produce refers to the choice of the combinations of factors and the particular technique to use in producing a good and service. Since a good or service can normally be produced with different factor combinations and different techniques, a problem arises as to which of these to use. This problem is common to all societies. Since resources are limited in every economy, when more of them are used to produce some goods and services, less are available to produce the others.

Therefore, society faces the problem of choosing the technique which results in the least possible cost to produce each unit of the goods or service it wants.

Market economy: this is solved based on the factor price by the price mechanism. Private produces choose low price technology to maximized profit and minimized cost of the production.

Planned Economy: this problem is solved based on the central planned by the panning authority. According to the availability of resources and nature of the product the government decides the technology such as capital intensive technology or labour intensive technology.

Whom to produce?

For whom to produce refers to determination distribution of national income among the factor owners of the economy. As resources are not enough to produce for every one of the societies, this problem is common to all societies.

Market economy: this is solved based on the demand for goods and services by the price mechanism. Private producers produce goods and services for high income people to maximize their profits.

Planned Economy: this problem is solved based on the central planned by the planning authority. This is solved by the government by taking into consideration of social welfare. They basically produce essential goods to the majority of people of the society.

(06 marks)

(Total 10 marks)

Suggested Answers to Question 03:

Chapter 02- Consumer behavior and market

(a) i. At equilibrium,

$$Q_d = Q_s$$

$$Q_d = 400 - 2p$$

$$Q_s = -100 + 3p$$

$$Q_d = Q_s \text{ at the equilibrium}$$

$$400 - 2p = -100 + 3p$$

$$500 = 5p$$

$$500/5 = p$$

$$100 = P$$

Equilibrium Price – Rs.100/-

(02 marks)

ii. $P=100$ is substituted to the Q_d equation,

$$Q_d = 400 - 2p$$

$$Q_d = 400 - (2 \times 100)$$

$$Q_d = 400 - 200$$

$$\underline{\underline{Q_d = 200}}$$

Equilibrium Quantity -200 Units

(01 mark)

(b) i. **Motives for demand for money**

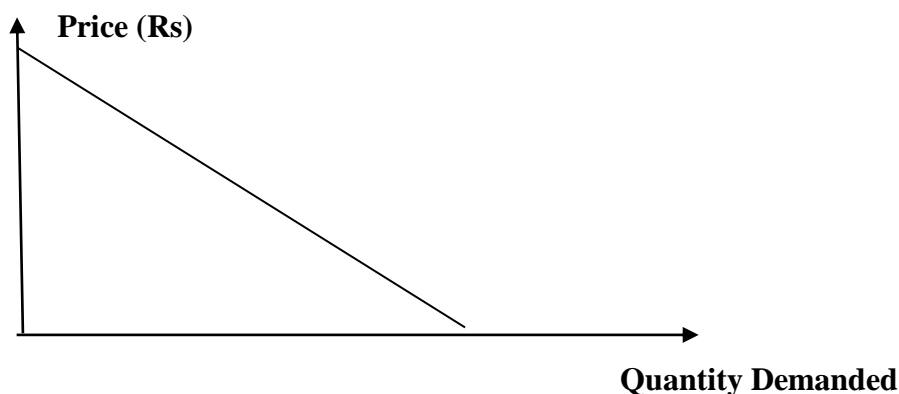
Demand curve is downward sloping due to the negative relationship between price and the quantity of demand due to **income effect** and **substitution effect**.

(1) **Income Effect**

When the price of a product changed, the real income of consumers is changed. Therefore the number of units that can be purchased from the income will be changed. This is known as income effect.

(2) **Substitution Effect**

When the price of a commodity falls the prices of other commodities will be relatively high. As a result a certain proportion of the demand for such commodities will be diverted to the commodity in which the price has fallen.

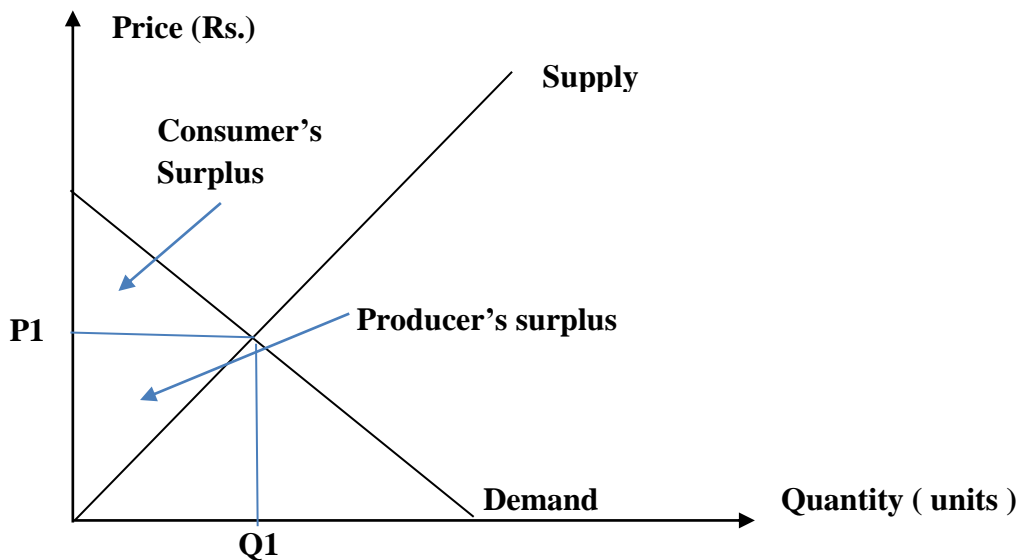


(03 marks)

ii.

Consumer surplus is the benefit derived by the consumer as market price of the product is determined below the maximum price which is prepared to pay by the consumers.

Producer surplus is the benefit derived by the producer as market price of the product is determined above the minimum price which is prepared to sell by the producer.



(04 marks)
(Total 10 marks)

Suggested Answer to Question 04:

(a)

Chapter 04- Role of the government within a market system
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i.

Sources of financing the budget deficit

Expansionary Sources

- 1) Borrowing from the Central Bank
- 2) Borrowing from the Commercial Bank

- 3) Obtaining Foreign Cash Loans
- 4) Using the cash balances of the government

Non-Expansionary Sources

- 1) Foreign grants.
- 2) Foreign aid.
- 3) Domestic non-market borrowing.
- 4) Domestic non-bank borrowing.

(02 marks)

ii. Advantages of public enterprises are given below.

- The main objective of a public enterprise is to provide a service and not to make profit; 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 the 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.
- Public enterprises can protect goods quality and standard
- The misconduct of public enterprises can be revealed through the representatives of the public.
- Security of employments is guaranteed.

(02 marks)

(b) Motives for demand for money

Unit -05 Money and price level

1. Transaction Motive

This is the interest that people have to hold money in the form of currency for the purpose finance day today transactions. The transaction motive for demanding money arises from the fact that most transactions involve an exchange of money. Because it is necessary to have money available for transactions, money will be demanded. The main determinant for transaction demand for money is real income and it is positively related.

2. Precautionary Motive

This is the interest that people have to hold money in the form of currency for the purpose finance unexpected (uncertain) transactions. Unexpected expenses, such

as medical or car repair bills often require immediate payment. Similar to the transaction demand for money, precautionary demand for money is positively related with real income.

3. Speculative Motive

Speculative demand for money refers the interest that people have to hold money in the form of currency in order to generate a return in the future. The speculative motive for demanding money arises in situations where holding money is perceived to be less risky than the alternative of lending the money or investing. The main determinant of speculative demand for money is interest rate as it indicates the opportunity cost of holding money. Interest rate is negatively related with speculative demand for money.

(06 marks)

(Total 10 marks)

Suggested Answer to Question 05:

Chapter 08- International Trade
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(a)

- i. Onion - Pakistan has the absolute advantage
Garlic - Pakistan has the absolute advantage

(02 marks)

ii.

Country	Onions(Kilograms)	Garlic(kilograms)
Pakistan	0.5	2
India	2	0.5

Pakistan has comparative advantage in the production of **Onion** as it can produce Onion at the lowest opportunity cost compared to India.

India has comparative advantage in the production of **Garlic** as it can produce Garlic at the lowest opportunity cost compared to Pakistan.

Working-Opportunity cost Calculation

Pakistan

Onion = $12/24 = 0.5$ units of Garlic

Garlic = $24/12 = 2$ units of Onion

India

Onion = $08/04 = 02$ units of Garlic

Garlic = $04/08 = 0.5$ units of Onion

(04 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.
- **A country may import things which it cannot produce**-International trade enables a country to consume things which either cannot be produced within its borders or production may cost very high. Therefore, it becomes cheaper to import from other countries through foreign trade.
- **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 which cannot be produced in their own country through international trade. Therefore they get diversity in choices.
- **Promotes international relationship**-International trade fosters peace, goodwill and mutual understanding among nations. Economic interdependence of countries often leads to close cultural relationship and thus avoid war between them.
- **Utilization of surplus production**-International trade enables different countries to sell their surplus products to other countries and earn foreign exchange.
- **Reduces trade fluctuations**-By making the size of the market large with large suppliers and extensive demand international trade reduces trade fluctuations. The prices of goods tend to remain more stable.

(04 marks)

(Total 10 marks)

End of the Section-A

A Compulsory question

(Total 20 marks)

SECTION - C

Suggested Answer to Question 06:

Chapter 07- Macro economy and Business environment

A. (a) Consequences of terrorist attack

- Decrease in confidence of the general public regarding the security of the country and drop in the arrival of tourists to Sri Lanka. This causes drop in business income of the economy
- Drop in the arrival of tourists will affect the hospitality industry and many services linked to tourism.
- After the attack, the widespread threat of terrorism weakens the investment climate. Both foreign and local investors are likely to withhold investments till there is a distinct improvement in security.
- Expenditure on rebuilding the destroyed churches, compensation for the large number who have died and the thousands injured that the government has promised would result in increased government expenditures that were not budgeted. This will result in a negative impact to the government budget.
- The slowdown in economic activity owing to the insecure conditions would reduce the national output and decrease the national revenue.
- The country's external financial vulnerability is increased as several items in balance of payments are adversely affected. This is specially, with respect of tourist earnings, foreign investments and capital inflows. It is therefore unrealistic to expect an improvement in the balance of payments as these sources of foreign earnings would be reduced.
- Several economic activities that have backward linkages with tourism and attached industries would be affected adversely. Travel, hotels, guest houses and other tourist accommodation, restaurants, arts and crafts, gem and jewelry sales would have a negative impact owing to the lower number of tourists.

(06 marks)

(b)

Chapter 04- Role of the government within a market system

The main purposes of indirect taxes can be stated as follows,

- (1) Generate tax revenue for a government
- (2) Discourage consumption of “harmful” products
- (3) Encourage consumption of “good” products
- (4) Discourage imports
- (5) Encourage producers
- (6) Save foreign exchange

(02 marks)

B.

Chapter 09- Economic Growth and Development

(a)

Gross Value Added (GVA) at basic price

	Rs.(Millions)
Agriculture, Forestry & Fishing	3,000
Manufacturing Mining and Quarrying	2,600
Construction	2,000
Wholesale and Retail ,Transportation, Storage, accommodation and food service activities	4,500
Information and Communication	2,000
Financial and insurance activities	2,500
Real estate activities including ownership of dwelling	1,200
Professional services and other personal service activities	2,000
Public administration, Defense , Education ,Human Health and Social work activities	10,500
Gross Value Added (GVA) at Basic price	30,300

(06 marks)

(b)

Gross Domestic Product at Market Price

Gross Value Added (GVA) basic price	30,300
Add: Indirect taxes	1,500
Less :Subsidies on Products	(1,000)
Gross Domestic Product (GDP) at Market Price	30,800

(03 marks)

C.

Importance of preparing national accounts;

- To assess economic performance.
- To make comparisons with other countries in the world.
- To measure economic growth.
- To understand the economic structure of the economy.
- To estimate per-capita national income.
- To forecast behaviour of macroeconomic variables.
- To have understanding about economic context and utilization.
- To identify functional relationships among economic factors.

(03 marks)

(Total 20 marks)

End of the 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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