SRI LANKA

Association of Accounting Technicians of Sri Lanka

Level I Examination – January 2022

Suggested Answers

(103) ECONOMICS (ECN)

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

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(103) ECONOMICS

SUGGESTED ANSWERS

(Total 40 Marks) **SECTION - A**

Suggested Answers to Question One:

1.1 (2)

1.2 (1)

1.3 (2)

1.4 (2)

Workings

PED = 100% / 50%

= 0.5(Less than 1)

1.5 (3)

1.6 (1)

1.7 (3)

1.8 (2)

1.9 (4)

1.10 (2)

1.11 Longrun

1.12 Falls

1.13 False

1.14 True

1.15 False

1.16 Factors that shifts the Demand curve to the right

1) Increase in the price of substitution goods.
2) Decrease in the price of complementary goods.
3) Increase in the consumer income.
4) Increase in the consumer taste and preference.

5) Expectation that the price of the good will increase in the future.
6) Increase in the number of consumers (buyers).

1.17 Characteristics of Oligopoly Market

1) Only a few firms operate in the entire market.
2) Existence of entry/ exit barriers.
3) Existence of interdependence among the firms in the industry.
4) Firms in an oligopoly produce either homogenous/identical or heterogeneous/differentiate products.
5) The firms in Oligopoly market face relatively an inelastic, downward slopping demand curve.

1.18 Change in demand

Rightward or leftward shift of the entire demand curve, due to change in any factor that influences the demand for a given good, except the price of the on good is referred to as the shift of the demand curve. There are two ways that this could happen.

1 Contraction of Demand

2 Expansion of Demand

Movement of the demand curve to the left as a result of the change in any factor that influences the demand for a good, except the price of the own good is referred to as contraction of demand. Movement of the demand curve to the right as a result of the change in any factor that influences the demand for a good, except the price of the own good is referred to as expansion of demand.

1.19 Long run production a production process

The long run production is the time period necessary for a firm to convert fixed factor inputs to variable inputs and the firms have more flexibility in either expanding or contracting production in the long run. All the factor inputs used in the production are variable inputs in the long run and there are no fixed factor inputs. Also the expansion of production capacity by firms result in economies of scale in the long run.

1.20

1) Savings
2) Imports
3) Government Taxes

(02 marks each, Total 40 marks)

End of Section A

Suggested Answers to Question Two:

Chapter 01 – Economic Concepts and Systems related to Business Environment

(a)

1) No limitation/ scarcity in supply
2) No resource cost
3) Zero opportunity cost
4) Not having a price
5) Gift of nature
6) Not having a clear ownership

(03 Marks)

(b). The basic economic problems of a planned economy is solved by the central planning authority/ government by using planning mechanism to maximize social welfare.

What to produce and in what quantities?

The question of what to produce refers to those goods and services and the quantity of each that the economy should produce. It is a problem of allocation of scare resources which have alternative uses of resources among the various economic activities.

In planned economic system, this problem is solved by a Central Planning Authority according to the social requirements. Based on the social requirements the central planning authority determines what goods to produce and in what quantities.

How to produce?

How to produce refers to the choice of the combinations of factors and the particular technique/s used in producing goods and services. Since a good or a service can normally be produced with different factor combinations and different techniques, a problem arises as to which of these technique/s to use.

In planned economic system, this problem is solved by a Central Planning Authority based on the availability of resources and nature of the product.

Eg - The Central Planning Authority determines whether to use capital intensive technology or labour intensive technology.

To whom to produce?

To whom to produce refers to the determination of the distribution of national income among the factor owners of the economy.

In planned economic system this problem is solved by the Central Planning Authority. This is solved by taking into consideration of the requirements of the society. The final objective of the Central Planning Authority is to maximize the common welfare of the people.

(04 Marks)

(c) Characteristics of labour

1) It is a live factor of production.
2) It is not homogeneous.
3) No limitations or barriers for mobility.
4) Productivity can be enhanced through training and education.
5) Income generated from labour is known as wages.

(03 marks)
(Total 10 marks)

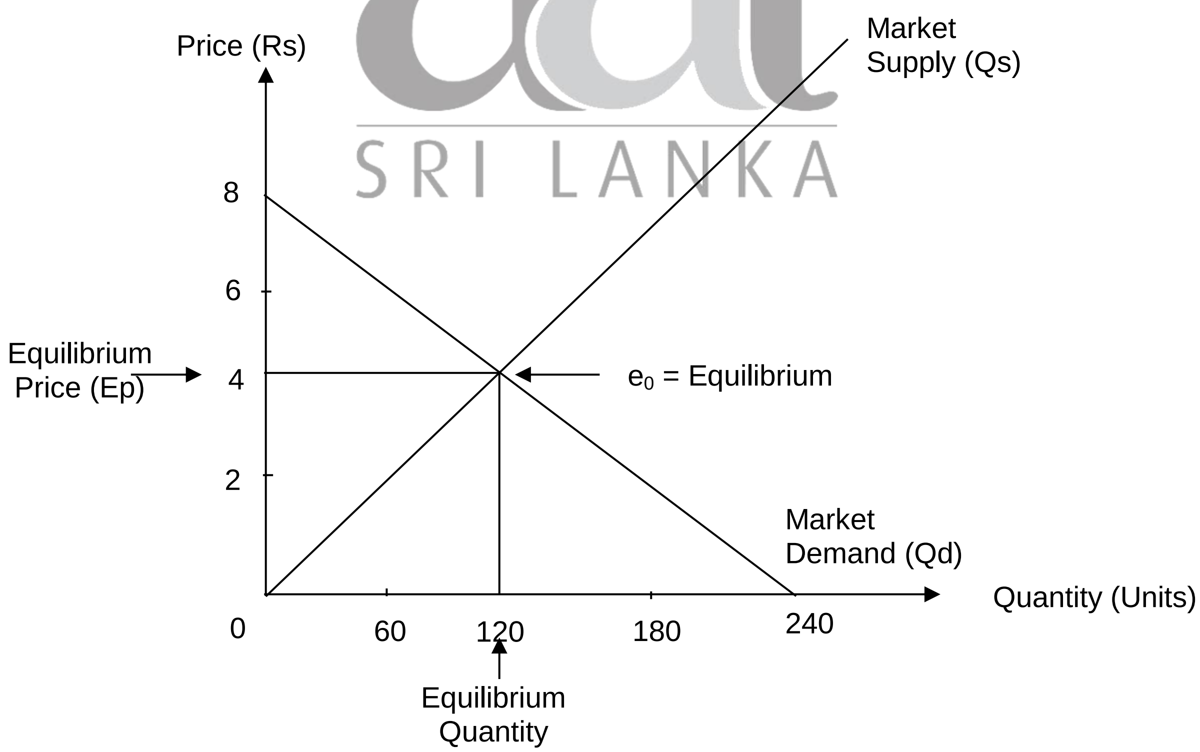
Suggested Answers to Question Three:

Chapter 02 – Demand, Supply, Equilibrium and Ways of Government Intervention

(a)

(i) Qd = 160 - 10p
Qs = 30p

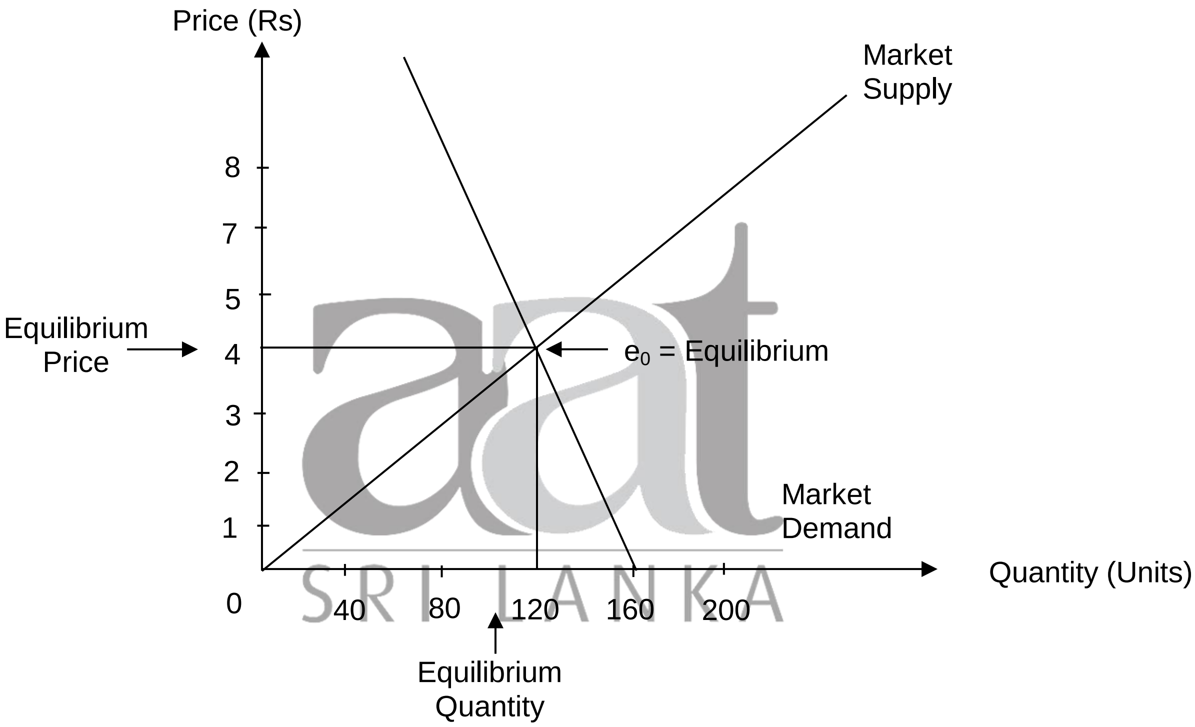
Price (Rs)	Quantity Demanded (units)	Quantity Supplied (units)
0	160	0
4	120	120
8	80	240
12	40	360
16	0	480



Equilibrium Price – Rs. 4/-
Equilibrium Quantity – 120 Units

Alternate Answer

Price (Rs)	Quantity Demanded (units)	Quantity Supplied (units)
0	160	0
1	150	30
2	140	60
3	130	90
4	120	120
5	110	150
6	100	180



(ii) Producer's Surplus

Producer's Surplus = $\frac{\text{(Equilibrium Price - Minimum Price) * Equilibrium Quantity}}{2}$

$= \frac{(4 - 0) * 120}{2}$

= **Rs. 240/-**

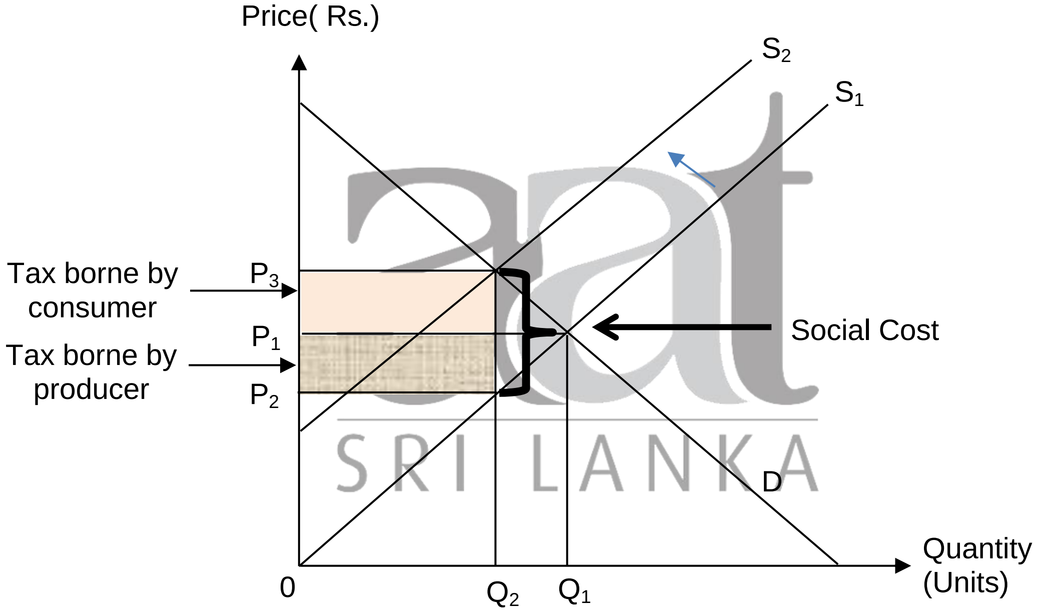
(b)Consequences of imposing a unit tax for a commodity

When a unit tax is imposed as an indirect tax for a commodity, the supply of the commodity will decline and the cost of production will rise. The market supply curve shifts to the left by the amount of tax and equilibrium price increases and quantity decreases.

Economic consequences of indirect taxes

1) Market supply decreases and supply curve shifts to the left.
2) Equilibrium price increases and equilibrium quantity decreases.
3) The vertical distance between supply curves before and after tax is equivalent to the amount of tax.
4) Consumers pay more and producers receive less due to the indirect taxes. Consequently, consumer surplus and producer surplus diminishes.
5) The tax burden falls on both consumers and producers, as a result both parties are discouraged.
6) Government tax revenue would increase with the indirect taxes.
7) There is no change in the quantities consumers intend to purchase at different prices, before and after the imposition of taxes, there is no change in the position of the demand curve.

Consequences of imposing Indirect tax can be illustrated as follows,



Suggested Answers to Question Four:

Chapter 5- Financial System, Money and General Price Level

(a) Various measures that can be taken to control inflation

1) Encourage producers to increase production.
2) Adopt strategies to accelerate the growth in aggregate supply
3) Adopt strategies to limit/slow down the growth in aggregate demand
4) Remove the barriers in the efficient distribution of resources.
5) Introduce credit control mechanisms.
6) Introduce price control mechanisms.
7) Stabilize exchange rate and minimize the trade deficit and Balance of Payment deficit.
8) Minimize imports and increase export income.

9) Increase interest rate/ bank rate to reduce demand for loans and credits.
10) Minimize government budget deficit
11) Restructure borrowings
12) Encourage and increase savings.

(b) Advantages of using electronic money

1) More efficient compared to other forms of money.
2) A safe method compared to physical currencies (low risk).
3) Quick and very convenient (easy usage) form of money and save time.
4) This money can be used in the international transactions across the world (portability).
5) More social recognition.

(03 Marks)

(c) Quantitative Controls

1) **Open market Operations**

Open market operations refer to the purchasing and selling of securities by the Central Bank in the open market to absorb or inject the excess liquidity. When there is an excess liquidity in the financial system, the Central Bank sells securities to the primary dealers and commercial banks as a result the excess liquidity is flowed to the Central Bank. On the other hand, securities are sold to inject liquidity as well.

2) **Bank Rate policy**

Bank rate is the minimum rate at which the central bank of a country provides to the commercial banks for their financial requirements. Through the changes in bank rate the Central Bank can influences the creation of credit by the commercial banks. If the bank rate is increases, the commercial bank also increase the lending rate of the banks as a result of high interest rates. As a result, the demand for loans decreases and money supply also decreases. The opposite consequences are emerged due to low interest rate.

3) **Reserve rate policy**

Reserve rate is the ratio of commercial bank deposits that are maintained as a cash reserve in the form of cash in hand or in the Central Bank. An increase or decrease of the reserve ratio will produce an increase or decrease in money supply.

(04 Marks)
(Total 10 marks)

Suggested Answers to Question Five:

Chapter 6- International Trade and Foreign Exchange Market

(a) Terms of Trade

Terms of trade is the rate at which one country's product is exchanged with a product of another country. It is the quantity of imports purchased for one unit of export. Terms of Trade is determined by import prices and export prices.

$$\textbf{Terms of Trade} = \frac{\textbf{Index of Export Prices}}{\textbf{Index of Import Prices}} \times 100$$

(03 Marks)

(b) Absolute advantage is the situation where a country produces a product or service at the lowest cost or highest efficiency compared to another country and obtains an advantage through the exchange of such goods with another products.

Example 1:

Sri Lanka and India produce Rice with homogeneous inputs. Cost of producing Rice in India and Sri Lanka would be as follows.

Country	Cost per Kg
India	Rs. 100
Sri Lanka	Rs. 150

According to the cost of the product in each country as illustrated above, **India has the absolute advantage in the production of Rice and Sri Lanka has absolute disadvantage in the Rice production.**

Example 2:

The number of units of rice and material which can be produces by one unit of labour by Sri Lanka and China are as follows.

Country	Material	Rice
Sri Lanka	8	5
China	4	7

Sri Lanka has an absolute advantage in producing material than China. China has an absolute advantage in producing Rice than in Sri Lanka.

(04 Marks)

(c)

Following measures could be used to reduce the impact of the devaluation of Sri Lankan currency.

1) Adopt strategies to encourage exports and increase the competitiveness of exports.
2) Take necessary measures to reduce the import expenditure.
   Eg: Discourage non-essential imports
3) Take necessary measures to reduce the external imbalances, in the same way which reduced the internal imbalances, with the utilization of domestic resources.
4) Allow the monetary policy to operate freely without any intervention.
5) Encourage local production of the country as substitutes of imports.
   Eg: Giving Subsidies to the local producers

(02 marks)
(Total 10 marks)

End of Section B

Total 40 Marks

SECTION - C

Suggested Answers to Question Six:

Chapter 4 – National Accounting and Role of the Government

(A)

(a)

	Item	Rs. millions
	Private Consumption Expenditure	7,500
	Government Consumption Expenditure	2,400
	Gross Domestic Capital Formation	**800**
(i)	**Gross Domestic Expenditure (GDE) at Market Price**	**10,700**

(04 Marks)

		Rs. millions
	Gross Domestic Expenditure	**10,700**
	Add : Exports	1,300
	Less : Imports	(2,000)
(ii)	**Gross Domestic Product (GDP) at Market Price**	**10,000**

(03 Marks)

		Rs. millions
	Gross Domestic Product at Market price	**10,000**
	Add : Net factor Income from Abroad	(600)
(iii)	**Gross National Income (GNI) at Market price**	**9,400**

(02 Marks)

(b)

1) Non-inclusion of productive activities taking place in informal economy.
2) Non-inclusion of dependent economic activities in national production.
3) Non-inclusion of services provided by housewives in national production.
4) Non-inclusion of interest paid on public debts in national production calculations.
5) Non consideration of damage to environment due to production activities.
6) Non consideration of changes of productivity in public services.
7) Inclusion of expenditure on defense and wars under productive activities.
8) Non-inclusion of some consumer goods with long life span in national production by categorizing them as investments.

(02 Marks)

Chapter 7 – Economic Growth Development and New Trends in Economy

(B) Consequences of having a negative economic growth of a country

1) Decrease in real national production of the country
2) Diminishing living standard of people
3) Depreciation of currency of the economy
4) Increase in inflation of the economy
5) Emergence of wider income disparities
6) Emergence of regional disparities
7) Increase in current level of consumption
8) Adverse impact on environment
9) Decrease in real income
10) Higher unemployment
11) Increase in debt burden of the country and difficult obtain additional debts from other countries.
12) Reduction in production
13) Adverse impact on the society and social issues.

(03 Marks)

Chapter 4 – National Accounting and Role of the Government

(C) Macroeconomic Objectives

1) Price Stability

To achieve price stability it is necessary to manage the economy without inflationary or deflationary pressures. Average price level in the economy is considered as stable when economy experiences very lower rates of inflation.

2) Full Employment

An economy achieves full employment level when all the resources in the economy are utilized in the full with maximum efficiency. When aiming at achieving full employment level it is necessary to minimize labour unemployment by increasing employment opportunities.

3) Equilibrium in Balance of Payment (BOP)

In order to achieve Balance of Payment equilibrium it is important to manage the economy without Balance of Payment crises when having exchanges across the boundaries.

4) Fair Distribution of income

Ensuring fair levels of income distribution among its population, a country is able to achieve equality. Income and wealth should be distributed in a way to ensure that every citizen of a country should have the ability to fulfill his/ her wants and needs.

5) Sustainable development

Enhancing the levels of production while protecting the quality of environment and also ensuring the benefits of development are distributed among the population, a country is able to achieve sustainable development. All aspects of development such as environment, economy and social is sustainable development.

6) Economic growth

Continuous increase in a country's Gross National Product (GNP) is identified as Economic Growth.

(06 Marks)
(Total 20 Marks)

End of Section C

Notice:

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