SRI LANKA

Association of Accounting Technicians of Sri Lanka

Level I Examination – January 2024

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 (4)

1.3 (3)

1.4 (1)

1.5 (3)

1.6 (1)

1.7 (2)

1.8 (1)

1.9 (3)

1.10 (2)

1.11 A monopolistic

1.12 Increasing

1.13 False

1.14 True

1.15

Economic growth is the continuous increase in the Gross Domestic Product (GDP) of a country. That is, the continuous increase in the production capacity of goods and services or the potential output.

The economic growth of a country is measured by the economic growth rate.

Alternative Answer:

$$\text{Economic Growth} = \frac{\text{Real GDP of Current year} - \text{Real GDP of the previous year}}{\text{Real GDP of the previous year}} \times 100$$

1.16

1 Existence of a large number of firms in the industry.

2 Each firm in the industry offering a differentiated products.

3 Free entry and exit

4 Downward sloping demand curve.

5 Perfect mobility of factors of production.

6 Monopolistically Competitive firms make normal profit or in other words zero economic profit in the long run.

7 The monopolistically competitive firm has the ability to change the price of the goods because the consumers believe that there are some differences between the goods even though the goods are the same because each firm produces different goods.

1.17

1 Acceptance of deposits

Demand Deposits, Savings Deposits, Time / Fixed Deposits.

2 Lending money

3 Short term loans

Discounting bills, loans on overdraft facilities, term loans,

4 Provision of agency services (selling and buying bills)

5 Provision of public utility services

Providing mortgage services providing necessary facilities for foreign exchange transactions providing support in foreign banking activities, Issuing letter of credit, and issuing credit cards

6 Collection of cheques and bills

7 Issuing letters of credit issuing letters of references.

8 Issuing travellers cheques

9 Safety locker facility

10 Modern facilities

11 Electronic Fund Transfer (EFT)

12 Automated Teller Machines (ATM)

1.18

- The law of supply is the positive relationship between the price of the commodity and the quantity supplied over a given period of time, other factors affecting supply being constant.

1.19

- The level of mobility of factors of production.
- Nature of the good.
- Ability to maintain stocks and shares.
- The time required to change supply in response to the change in price of the given good.
- Cost of Production

1.20

- Modernization.
- Improvements in the production methods and technology.
- Increased momentum in the industrialization.
- Improvements in the productivity of factor inputs.
- Decline of level of poverty, unemployment and also income disparities.
- Change in the structure of production sector.

(02 marks each, Total 40 marks)

Suggested Answers to Question Two:

(a)

- Land
- Labor
- Capital
- Entrepreneurship

(02 marks)

(b)

- When there is no shortage of resources
- When there are no alternative uses of resources
- When employing unemployed resources

(02 marks)

(c) Because the resources of an economy are limited and all needs cannot be met with those limited resources, every economy faces three basic economic problems.

What to produce?

This means that what goods and services are produced using scarce resources, every economy faces this problem because resources are scarce and there are alternative uses of scarce resources. The basic economic question of what and how much is produced can also be termed as the **problem of resource allocation** because what/how much is produced and resources are allocated for that purpose.

How to produce?

What production techniques are used? This means There are two alternative methods that an economy can choose. They are the labor intensive and the Capital intensive. The basic economic question of how to produce is also known as the **question of production** because production takes place using one of the alternative production techniques.

To whom to produce?

This refers to which group of society the goods produced are given to. That is, who will own the limited amount of goods and services produced using scarce resources? The amount of goods produced in this way is determined by the income of each individual, for whom it should be produced is also known as the **problem of income distribution.**

(06 marks)

(Total 10marks)

Suggested Answers to Question Three:

(a)

Qd = 200 – 3P

Qs = - 100 + 2P

Equilibrium price and equilibrium quantity

Qd = Qs

200 – 3P = - 100 + 2P

$$\frac{-5P}{-5} = \frac{-300}{-5}$$

<u>P = 60</u> Equilibrium price

Qd = 200 – 3P

P = 60

Qd = 200 – 3 × 60

Qd = 200 – 180

<u>Q = 20 Units</u>

(03 marks)

(b)

(i)

Fixed Factor Land(Acres)	Variable Factor (Labor)	[Total Product (TP) Units	Average Product (AP)	Marginal Product (MP)
1	0	0	**0**	**0**
1	1	8	**8**	**8**
1	2	18	**9**	**10**
1	3	33	**11**	**15**
1	4	36	**9**	**3**

(04 marks)

(ii)

Total Product (TP)

Initially increases at an increasing rate, then increases at a decreasing rate, reaches a maximum and begins to decrease.

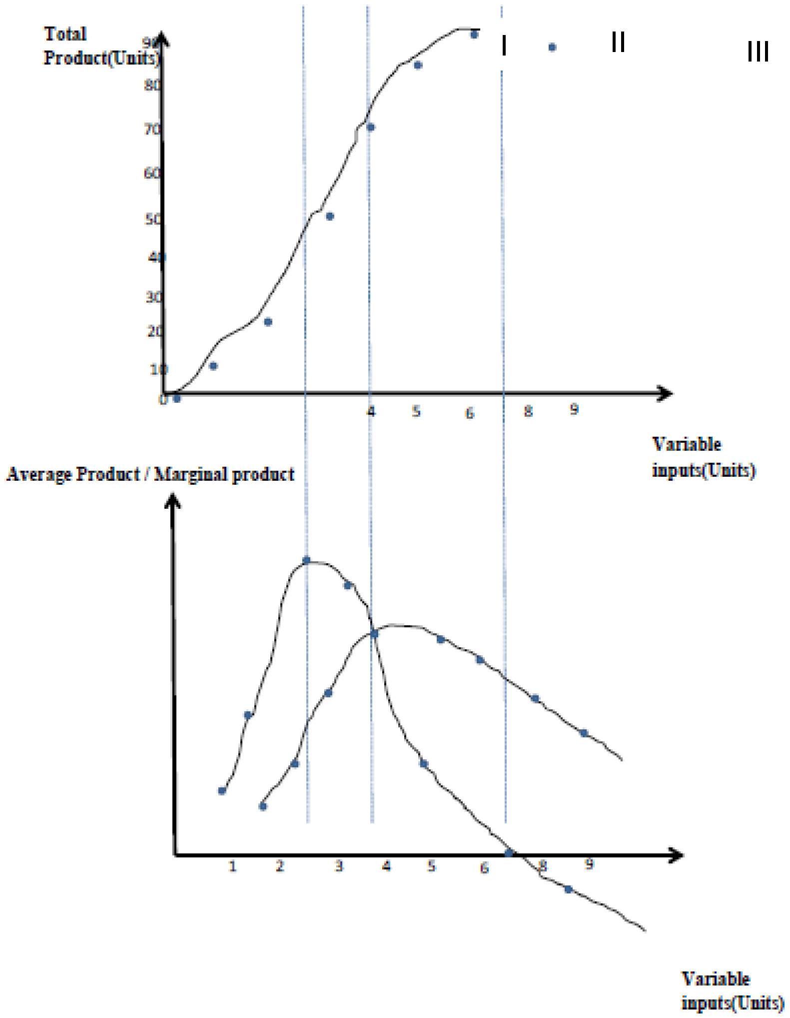
Average Product (AP)

As total product increases, average product rises to a maximum and as total product increases at a decreasing rate, average product falls.

Marginal Product (MP)

When total product increases rapidly, marginal product rises to a maximum, when total product increases at a decreasing rate, marginal product falls, when total product is maximum, marginal product becomes zero, and when total product decreases, marginal product becomes negative. The marginal product curve shifts downward, intersecting the maximum point of the average product curve.

This can be presented with a diagram as follows.



Stage I

Total Product: Increases at an increasing rate

Average Product: Increases to a maximum.

Marginal product: rises and falls.

Stage II

Total Product: Increases at a decreasing rate.

Average Product: Decreases.

Marginal product: Decreases to zero.

Stage III

Total Product: Decreases.

Average Product: Decreases.

Marginal product: is negative.

(03 marks)

(Total 10 Marks)

Suggested Answers to Question Four:

(a) Macroeconomic variables that determine money demand

- Real income
- Rate of interest
- Price level
- Future prospects
- Organizational factors
- Financial market innovation

(03 marks)

(b) When an increase in the price level will cause an increase in average interest rate on economy. In contrast a decrease in the price level will cause a decrease in average interest rate in an economy.

(03 marks)

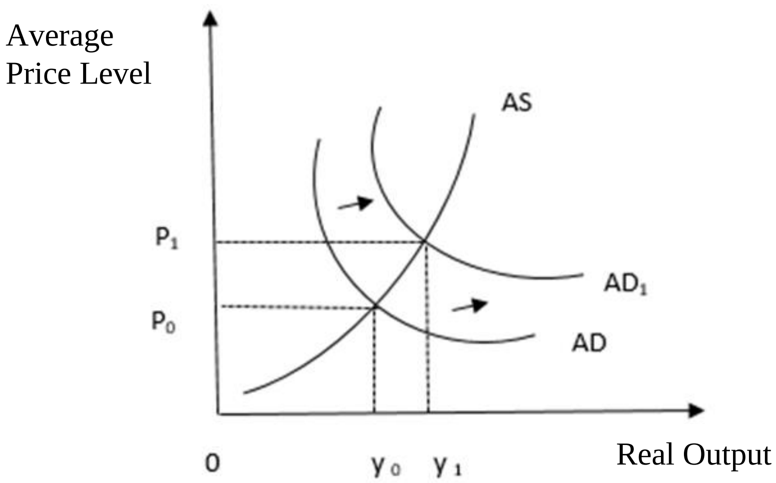
(c) Causes of inflation

1. Demand-pull inflation
2. Cost-push inflation

- **Demand-pull inflation**

An increase in the general price level of goods and services due to an increase in aggregate demand over aggregate supply is known as demand-pull inflation.

This can be presented with a diagram as follows.



While the Aggregate supply remains unchanged, the general price level of the economy has increased from P_0 to P_1 due to increase in Aggregate demand from AD to AD_1.

There are two alternative approaches to explaining demand-pull inflation.

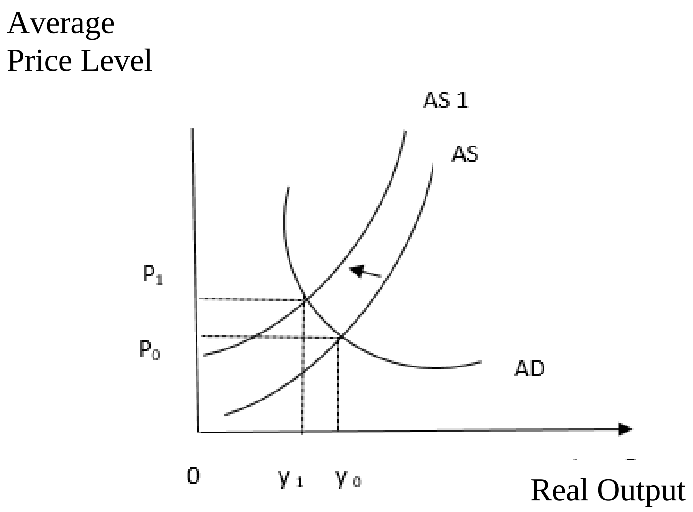
1. Keynesian theory
2. Quantity theory of Money

- **Cost-push inflation**

An increase in the general price level due to an increase in input prices or costs is known as cost-push inflation.

Cost-push inflation is caused by rising input prices, rising fuel prices, supply shocks, and rising costs as monopolistic competitive firms seek to increase profits.

This can be presented with a diagram as follows.



The general price level of the economy has increased from P_0 to P_1 due to decrease in the Aggregate Supply from AS to AS_1

(04 marks)
(Total 10 marks)

Suggested Answers to Question Five:

(a)

Positive Impacts:

1. Important for national security: Trade barriers can be implemented to safeguard vital industries and resources essential for national security, ensuring self-sufficiency in critical sectors.

2. Helping to resolve balance of payments difficulties: By restricting imports, trade barriers can reduce the trade deficit and stabilize the country's balance of payments, thereby improving the overall economic stability.

3. Protection of local infant industries: Trade barriers provide a protective shield for emerging industries, allowing them to develop and become competitive in the global market, thereby fostering economic growth and diversification.

4. Important to protect local employment: Trade barriers help in preserving domestic jobs by shielding industries from foreign competition, thus maintaining employment levels and preventing job losses.

5. Prevent imports of harmful goods: Trade barriers can be used to regulate the import of goods that pose risks to public health, safety, or the environment, safeguarding the well-being of the population.

6. Increase the utilization of local resources: By restricting imports, trade barriers encourage the utilization of local resources and promote domestic production, leading to enhanced economic self-reliance.

Negative Impacts:

1. Impeding the migration of advanced technology: Trade barriers can limit access to advanced technologies and innovations from foreign markets, hindering technological progress and innovation within domestic industries.

2. Decreased production of high-quality goods: Barriers may result in reduced competition and innovation, leading to a decline in the quality of domestically produced goods as producers face less pressure to improve.

3. Reduction of national income due to contraction of domestic and foreign markets: Trade barriers can shrink both domestic and foreign markets, leading to decreased exports and imports, which in turn can negatively impact national income and economic growth.

4. Inefficient industries may arise: Protectionist policies can lead to the development of inefficient industries that are shielded from international competition, resulting in higher production costs and reduced competitiveness in the long run.

(03 marks)

(b)

Disadvantages of depreciating a country's currency

- Rising domestic prices of imports.
- Higher import costs than before.
- Increase in domestic inflation if domestic demand is dependent on imports.
- Increase in foreign loan premiums and interest payments
- Reducing foreign direct investment

(03 marks)

(c)

Country	**Corn**	**Rice**
Argentina	12/ 24 = 0.5	24/12=2
China	8/4 = 2	4/8 = 0.5

In Argentina the opportunity cost of 24 kilograms of Corn is 12 Kilograms of rice. The opportunity cost of 1 kilogram of corn is 0.5 kilograms of rice

In China the opportunity cost of 4 kilograms of Corn is 8 Kilograms of rice. The opportunity cost of 1 kilogram of corn is 2 kilograms of rice.

Thus Argentina has the lowest opportunity cost of corn production (0.5 < 2). Therefore, Argentina has the comparative advantage in corn production

In Argentina the opportunity cost of 12 kilograms of rice is 24 Kilograms of corn. The opportunity cost of 1 kilogram of rice is 2 kilograms of corn.

In China the opportunity cost of 8 kilograms of rice is 4 Kilograms of corn. The opportunity cost of 1 kilogram of rice is 0.5 kilograms of corn.

Thus, China has the lowest opportunity cost of rice production (0.5 < 2). Therefore, China has the comparative advantage in rice production

(04 marks)

(Total 10 marks)

End of Section B

Total 40 Marks

SECTION - C

Suggested Answers to Question Six:

(A)

(a) Existing limitations of national accounts data

- Exclusion of productive products occurring in the informal economy.
- Subsistence economic activities are not included in the national accounts.
- Non-inclusion of the services provided by the housewives in national production.
- Public debt interest is not included in the calculation of national accounts
- Environmental damage caused by production is not included in national accounts.
- Disregarding changes in public services.
- Expenditure on military and defense activities is considered productive expenditure.
- Non consideration of changes of productivity in public services.

(03 marks)

(b)

The price that the buyer (customer) actually pays for the goods and services is called the purchaser's price. In addition to the producer's price, the purchaser's price is made up of freight charges, trade margins and net taxes payable by the consumer.

Purchaser's Price = Producer's price + merchant margin and transport charges charged by middlemen + Taxes on goods charged to consumers - Subsidies given by government to traders on behalf of consumers

(03 marks)

(B) (a)

	Item			**Rs. million**
1.	Private consumption expenditure		=	2,000
2.	Government consumption expenditure		=	6,500
3.	Gross domestic capital formation		=	5,200
	3.1 Gross domestic fixed capital formation	2,500		
	3.2 Changers in stock	2,700		
	Gross Domestic Expenditure (GDE) at market price 1 + 2 + 3		=	**13,700**

(05 marks)

(b)

	Item		Rs. million
1.	Gross domestic expenditure(GDE)	=	13,700
2.	Add: Exports	=	7,600
	Less : Imports	=	(9,900)
	Gross Domestic Product (GDP) at market price	=	**11,400**

(03 marks)

(c)

	Item		Rs. million
1.	Gross domestic product (GDP) at market price	=	11,400
2.	Foreign net primary income	=	500
	Gross National Income (GNI) at market price	=	**11,900**

(02 marks)

(C)

- Increased tax rates reduce the after-tax reward to working individuals
- Increased tax rates discourage savings and investments of individuals and businesses as investment income is subject to various taxes at high rates.
- Prices of goods and services increases
- Due to increase in income taxes, individuals' standard of living could be affected
- Changes in VAT policy increases the costs of businesses and therefore, businesses might evade taxes
- Due to higher costs of manufacturing, price of goods increases due to taxes and that will affect low-income consumers.

(04 marks)
(Total 20 marks)

End of Section C

Notice:

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