



Association of Accounting Technicians of Sri Lanka

July 2016 Examination - AA1 Level

**Questions and Suggested Answers
Subject No : 13**

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

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA
EDUCATION AND TRAINING DIVISION

AA1 Examination - July 2016
(13) Economics for Business & Accounting

SUGGESTED ANSWERS

SECTION – A

Objective Test Questions (OTQs)

Answers to ALL questions are expected.

(Total 40 marks)

Suggested Answers to Question One:

Question No	Answer
1.1	2
1.2	1
1.3	2
1.4	3
1.5	3
1.6	4
1.7	4
1.8	1
1.9	2
1.10	1
1.11	FALSE
1.12	TRUE
1.13	FALSE
1.14	TRUE
1.15	TRUE
1.16	Increases
1.17	Falls
1.18	Nominal GDP
1.19	Narrow Money Supply (M1)
1.20	Broad Money Supply (M2)

End of Section A

Four (04) compulsory questions
(Total 40 marks)

Suggested Answers to Question Two:

(a)

- i. The economic system in Sri Lanka is a **mixed economic** system. It is a combination of capitalist economic system (market economic system) and Socialist economic system (Planning Economic system).
- ii. Economic systems are categorized based on property ownership, problem solving mechanism and incentive system. Evidence for mixed economic system in Sri Lanka can be summarized as follows,
 - **Property ownership:** Sri Lanka has public and private property ownership. Some resources are owned by the government and others are controlled by the private property owners.
 - **Problem solving mechanism:** Price Mechanism and Planning Mechanism are used to allocate resources and distribute goods and services in the society.
 - **Incentive system:** Private sector decides production and other economic activities based on profit motive where as government sector carries out economic activities so as to maximize social welfare.

(b) **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.

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.

For 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 society, this problem is common to all societies.

(Total 10 marks)

Suggested Answers to Question Three:

(a)

- i. If the government expenditure exceeds the government revenue of the budget in the given financial period, it is known as overall budget deficit. This is the situation where addition of current and capital expenditure of the government exceeds the addition of tax and non-tax revenue of the government.

Overall government deficit can be calculated as follows,

Total government Revenue	xx
<i>Less:</i> Recurrent expenditure	(xxx)
Balance of current account	<u>xx</u>
<i>Less:</i> Capital Expenditure	(xx)
Overall budget deficit	<u><u>(xx)</u></u>

- ii. Government budget financing sources can be summarized as follows,

Domestic sources

- Non Banking Sources
 - National Saving bank
 - Employees Provident Fund
 - Employees Trust Fund
 - Lotteries Board
- Banking Sources
 - Central Bank of Sri Lanka
 - Commercial Banks

Foreign Sources

- Foreign Aids and Grants
- Foreign Loans (Institutions & Countries)

(b)

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.
- The misconduct of public enterprises can be revealed through the representatives of the public.
- Security of employments is guaranteed.

(10 marks)

Suggested Answers to Question Four:

(a) Functions of money can be explained as follows,

Medium of Exchange

Money can be used to exchange goods and services in the society. This is the most significant function of money. People can purchase goods and services by using money and receive money by providing goods and services. This function can also be treated as primary function of money.

Store of value

Money can be used as a store of value by choosing saving and sacrificing present consumption in order to increase the purchasing power in the future. People can accumulate their wealth or assets in different forms; money can also be added to the forms wealth accumulation. This function is known as asset function of money.

Unit of account (Measure of Value)

Money as a common unit of account enables us to compare the relative prices of goods and services in rupees and cents. Value of goods, services or assets can be measured in terms of money.

Standard of differed payments

Money allows payment for goods and services consumed today in a future time periods. Individuals and organization can borrow money or goods and settle in the future in terms of money.

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- (b) Functions of commercial banks can be stated as follows,
- Attract deposits from public through savings, current, Time/FD deposits.
 - Lending money in the form of loans or overdraft.
 - Banks provide a payment mechanism, whereby individuals, firms and government can make payment each other.
 - Provide a place for individuals, firms and government to store their wealth.
 - Providing safety vaults for individuals to safeguard jewellerys and other valuables
 - Advising and assisting individuals and companies on investment matters.
 - Provide assistance for exporters and importers by facilitating international trade through operating letter of credit, etc...
 - Facilitating foreign currency transactions.

(10 marks)

Suggested Answers to Question Five:

- (a) **Terms of trade** is the import purchasing power of an export unit of product, It measures number of foreign product that can be imported by exporting a unit of domestic product.

$$\text{Terms of Trade} = \text{Index of Export prices} / \text{index of import prices} \times 100$$

- Terms of trade depends on the relative prices of a country's export to import.
 - The advantages of international trade to a country can be basically determined by using terms of trade. An improvement in a country's terms of trade is good for that country in the sense that it has to pay less for the products it imports.
 - Since the international trade of a country involves a large number of countries and products, export and import price indices are used to calculate the terms of trade.
- (b) i. **Economic Growth** is the expansion of a production ability of an economy over time. It is an increment of the Real Gross Domestic Production of the economy over time. Economic growth is affected by increase in quantity of resources, productivity and improvement in technology of an economy over time. Economic growth can be measured by using economic growth rate.
- ii. Advantages of economic growth can be summarized as follows,
- Economic growth helps to improve living standards of people by increasing per-capita income and reducing poverty.
 - Economic growth creates more jobs since the investments and production increase in the country.
 - Business confidence is enhanced
 - It creates a favorable fiscal environment as government revenue increases.
 - Economic power of a country increases.

(10 marks)

End of Section B

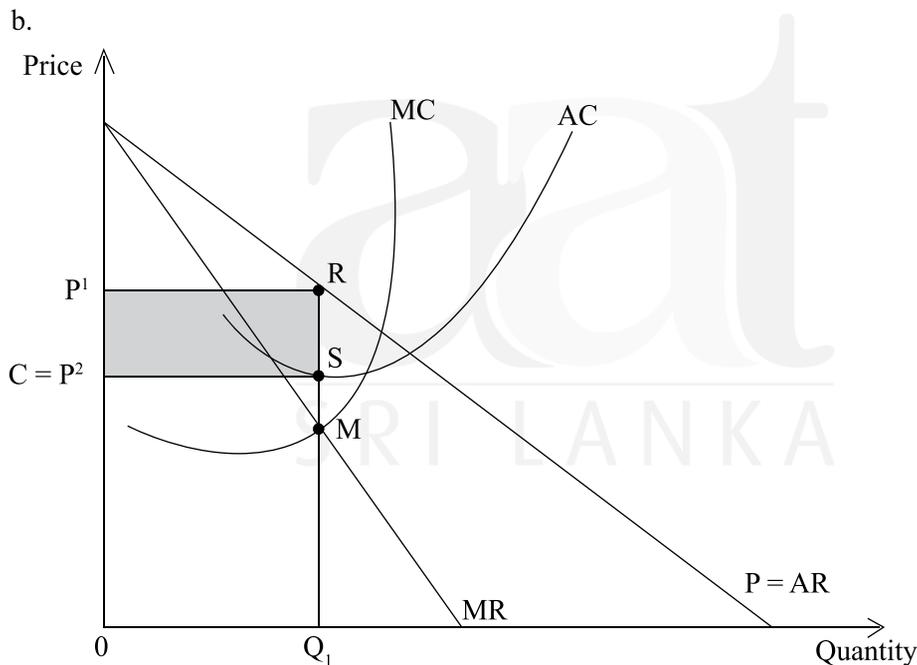
A compulsory question.

(Total 20 marks)

Suggested Answers to Question Six:

(A) a. **Main characteristics of Monopoly:**

- Existence of a single firm in the market (Single seller)
- A unique product is sold in the market, it is known as heterogeneous product
- Extremely difficult or impossible entry into market
- Consumers do not have perfect knowledge about the price and product



The profit maximizing point is **M** where **MR = MC**. The equilibrium quantity is Q_1 and price is P_1 .

Supernormal profit = P^2P^1RS

The monopoly firm earns supernormal profits, because the selling price is higher than the average cost (AC).

The monopolist produces Q^1 units of the product. At this equilibrium, the average cost is P^2 .

The price P_1 is higher than the average cost P_2 .

Total revenue	Op^1RQ^1
Less - Total cost	Op^2SQ^1
Supernormal profit	<u><u>P_2P_1RS</u></u>

(B) a.

1. GDP is the aggregate of values added from the economic activities that has taken place within the geographical boundary of a country. That is the value of all final goods and services produced within the geographical boundary of a country.

GNP is the money value of goods and services produced within and outside the country by the residents of a country during a period of time such as a year. Here, the importance is this considers the goods and services produced by the residents of the country and not the territory in which it is produced.

2. Gross Domestic Production	=	xxxx
Add/Less : Net Factor Income from abroad	=	xx / (x)
Gross National Production	=	<u><u>xxxx</u></u>

3. Net Factor Income from abroad (NFIA) = Factor income receipts from abroad - Factor income payments to abroad

Therefore, **GNP** = **GDP +/- NFIA**

4. If NFIA is positive the GNP is higher than GDP. If NFIA is negative GNP is less than GDP.

b.

Item	Rs. (Millions)
Employment Income	360,000
Rent Income	220,500
Self Employment Income	190,500
Profit earned by Business Sector	210,600
Interest Income	162,000
Net Domestic Product / Income FC	1,143,600
Add : Capital Depreciation	130,600
Gross Domestic Product / Income FC	1,274,200
Add : Indirect Taxes	120,300
Less : Subsidies	(100,500)
Gross Domestic Product / Income MP	1,294,000
Add : NFIA	(94,000)
Gross National Product / Income MP	1,200,000

(Total 20 marks)

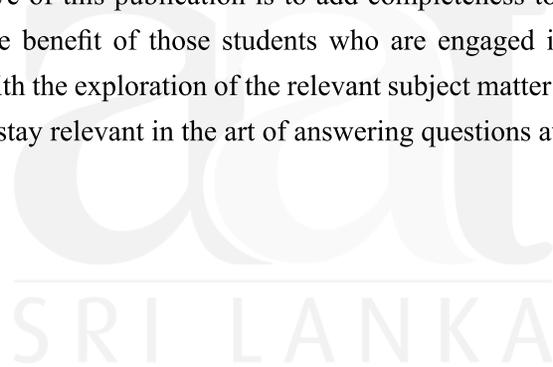
End of Section C

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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