



Association of Accounting Technicians of Sri Lanka

July 2017 Examination - AA1 Level

**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 - July 2017
(AA13) Economics for Business & Accounting

SUGGESTED ANSWERS

SECTION – A

Objective Test Questions (OTQs)

Twenty (20) compulsory questions.

(Total 40 marks)

Suggested Answers to Question One:

Question No	Answer
1.1	2
1.2	3
1.3	4
1.4	2
1.5	2
1.6	2
1.7	4
1.8	1
1.9	4
1.10	4
1.11	FALSE
1.12	FALSE
1.13	TRUE
1.14	FALSE
1.15	TRUE
1.16	Zero
1.17	Positively
1.18	Commercial Banks
1.19	Sustainable Development
1.20	Unemployed

(02 marks each, Total 40 marks)

End of Section A

Four (04) compulsory questions
(Total 40 marks)

Suggested Answers to Question Two:

(a) Anything that can be used in unlimited quantities to produce goods and services and do not associate with opportunity cost in the production process are known as **Non-economic resources**.

Examples: Rain water, sun light, natural air.

Non-economic resources have following attributes,

- No limited in supply (no scarcity)
- Opportunity cost is not associated
- There is no market or price for non-economic resources
- Individual ownership

(03 Marks)

(b) Price Elasticity of Demand (PED) = $\frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}}$

$$\text{PED} = \frac{\% \Delta Q_d}{\% \Delta P}$$

$$\text{PED} = \frac{\Delta Q_d}{\Delta P} \times \frac{P}{Q_d}$$

$$= \frac{5}{1} \times \frac{10}{20} \quad \text{or}$$

$$= \frac{25\%}{10\%}$$

(03 Marks)

$$= \underline{\underline{2.5}}$$

(c)

	Perfect Competition	Monopoly
1	There are very large number of firms in the market	There is a single firm in the market / industry
2	Product are homogeneous	Product are heterogeneous (unique)
3	There are no entry and exit barriers	There are entry and exit barriers
4	Firms make only normal profit in the long-run equilibrium	Can earn economic profits in the long run equilibrium as well as in the short run.
5	It is a price taker. One market price.	It is a price maker. Price set by the firm possible price discrimination.
6	Firm's Demand curve is a perfectly elastic demand curve	Firm's Demand curve is a downwards sloping demand curve

(04 Marks)

(Total 10 marks)

Suggested Answers to Question Three:

(a)

- i. The statement is a correct statement. (Agree with the statement)

(01 Marks)

- ii. The demand for factors of production depends on the demand for the goods being produced with the factors of production. The demand for factors of production is determined by the producers of the goods on the demand for goods produced with the factors of production. The factors of production are owned by the households and they determined the supply on price that they can get. The price is determined on the demand and supply of the factors of production.

(03 Marks)

(b)

1. Increasing returns to scale

When all factors are increased in a given proportion, output increases in a greater proportion. If labour and capital are increased by 100% output rises by more than 100%.

2. Decreasing returns to scale

When output increases in a smaller proportion than the increasing all inputs, there are decreasing returns to scale.

3. Constant returns to scale

When all factors of production are increased in a given proportion, the output produced would increase in exactly the same proportion. All inputs are reduced by a given proportion, output is reduced by the same proportion.

(06 marks)

(Total 10 marks)

Suggested Answers to Question Four:

(a)

- (i) 1. General Acceptability
2. Portability
3. Durability
4. Divisibility
5. Homogeneity
6. Cognoscibility
7. Stability
8. Recognizability
9. Elastic
10. Standardize
11. Malleable

(04 Marks)

- (ii) The Demand for money is the desired holding of financial assets in the form of money. The demand for money is affected by several factors, including the level of income, interest rate and inflation as well as uncertainty about the future. The demand for money is explained in terms of three motives (reasons for the demand for money) namely, transaction motive, precautionary motive and speculative motive.

(03 Marks)

(b) Functions of the Central Bank can be stated under different categories as follows,

Core Functions

- Economic and Price Stability
- Financial System stability

Ancillary to core functions

- Currency issue and management

Agency Functions

- Employees' provident fund management
- Foreign Exchange management
- Public debt management
- Regional Development

Relationship with commercial banks and controlling commercial banks (banker of the banks)

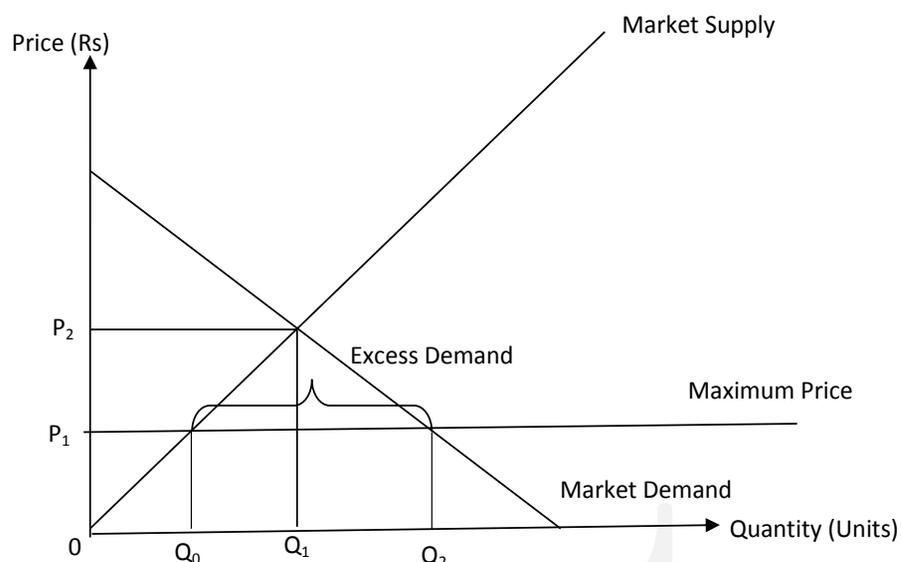
- Relationships with Commercial Banks.

(03 Marks)

(Total 10 marks)

Suggested Answers to Question Five:

(a) Maximum price policy can be illustrated as follows,



Economic consequences of a maximum price policy.

- Quantity of demand increases and quantity of supply decreases. Therefore an excess demand creates in the market.
- Black markets and black market price will emerge due to shortage of commodity in the market.
- Shortage of goods and the formation of long queues to purchase goods.
- Implements quota systems and Subsidization scheme etc.. are introduced by the government as remedies.
- Import the excess demand
- Encourage firms to increase their supply.
- Introduction of low quality products to the market.
- Government takes necessary actions to overcome adverse outcome.

(06 Marks)

(b) Advantages of protectionism

- Protect domestic producers from extra competition from foreign countries.
- Help new businesses (infant industries) of the economy to develop before they face competition.
- Helps to protect economy's jobs (protect local employments)
- Prevent foreign counties dumping lots of cheap imports into the country.
- Prevent imports of harmful goods
- Reduce import expenditure for improving the balance of payments.

(04 Marks)

(Total 10 marks)

End of Section B

A compulsory question.

(Total 20 marks)

Suggested Answers to Question Six:

A.

- (a) Three economic systems are;
- Capitalist Economic System (Market economic system)
 - Socialist Economic system (Command Economic System / Planned economic system)
 - Mixed economic System

(b) (1) The Capitalist / Market Economy

Basic economic problems are solved through the use of price mechanism. The profit motive is the motivating factor in market economies.

What and how much should be produced:

In a market economy this is solved on the basis of relative prices of goods and their profitability. A comparison is made between the prices of goods. The producer will allocate more resources to the production of goods which command higher prices and ensure higher profits.

How to produce:

Most profitable goods and services produced at the minimum cost based on factor prices.

For whom to produce:

To those who can afford the price. This is depend on purchasing power.

(2) The Socialist / Planned / Command Economy

What and how much should be produced:

Determined by a central planning authority. After the production domains are determined, then how much or what quantity to be produced will be decided. Goods and Services are produced according to the requirements of the society. Much attention is not paid to prices. Resources are allocated to the production of essential goods which have greater significance to the society.

How to produce:

The centralized authority organizes the planned economy. Production institutions are government enterprises. The techniques are determined through the commands given by centralized authority.

For whom to produce:

This is solved by the decisions of the central planning council which are based on the requirements of the society and objective of enhancing public welfare. Economy factor prices are incentive to the market forces and the centralized authority make the decisions about the prices.

(3) The Mixed Economy

Mixed economy is combined the features of market economies and planned economies. They are used both price mechanism and planning systems.

What and how much should be produced:

The private sector tends to produce the goods that command the higher prices and provide higher profits. The government sector produces goods with the motive of increasing social welfare. Government influences prices, through taxes and subsidies and affects the operation of price mechanism directly and indirectly.

How to produce:

The private sector uses more profitable and least cost methods of production. The government's choice of production techniques are based on social justice.

For whom to produce:

Mixed economy is determined this problem by the purchasing power of the public and it is influenced by the government. The purchasing power of the public depends on the ownership of human and material resources. Government intervention alters the purchasing power of the public.

Eg.- Imposing of progressive taxes on income and wealth, granting subsidies to low income groups, introduction of social security schemes.

(06 Marks)

B

(a)

	Rs.(Millions)
Agriculture, Livestock and Forestry & Fishing	250
Fishing	120
Mining and Quarrying	75
Manufacturing	100
Electricity, Gas and Water	200
Construction	80
Wholesale and Retail Sale	150
Hotels and Restaurants	100
Transport and Communication	160
Banking, Insurance and Real Estate	135
Ownership of Dwellings	200
Government Services	160
Private Services	250
Gross Domestic Product at Factor Cost Prices for the year 2016	1,980

(05 marks)

(b)

Item	Rs.(Millions)
Gross Domestic Product at Factor Cost Prices	1,980
Add : Indirect taxes	150
Less : Subsidies	(100)
Gross Domestic Product (GDP) at market prices for the year 2016	2,030

(03 marks)

(c) **Real Gross Domestic Product (Real RDP) 2016**

		Rs.(Millions)
Gross Domestic Product (MP) for 2016	=	2030
Price Index for the year 2016	=	125
Real Gross Domestic Product (MP) for 2016	=	$2030/125 \times 100$
	=	<u><u>1,624</u></u>

(03 marks)

(Total 20 marks)

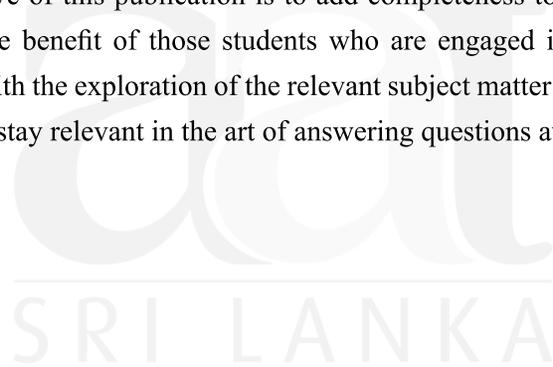
End of Section C

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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