



Association of Accounting Technicians of Sri Lanka

AA1 Examination - January 2020

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 - January 2020
(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 | 4 |
| 1.2 | 2 |
| 1.3 | 2 |
| 1.4 | 4 |
| 1.5 | 4 |
| 1.6 | 4 |
| 1.7 | 3 |
| 1.8 | 2 |
| 1.9 | 2 |
| 1.10 | 1 |
| 1.11 | False |
| 1.12 | True |
| 1.13 | True |
| 1.14 | True |
| 1.15 | True |
| 1.16 | decreasing |
| 1.17 | Narrow |
| 1.18 | long-run |
| 1.19 | Marginal cost |
| 1.20 | Capital Accumulation |

(02 marks each, Total 40 marks)

End of Section A

Four (04) compulsory questions
(Total 40 marks)

Suggested Answers to Question Two:

| |
|---|
| Chapter 01- Introduction to Business Economics |
|---|

(a) (i) Scarcity

Scarcity is the gap between the unlimited human needs and limited resources.

It explains the inadequacy of resources to produce all goods and services to satisfy all needs of all human beings.

(02 marks)

(ii) Economic resources are limited and people cannot have all the goods and services they want. As a result they must choose. Whenever a choice is made something is given up. The opportunity cost is the value of the best alternative given up. Opportunity cost arises whenever people force to make choices among available alternatives.

(03 marks)

(b) (1) Only the government sector is operating in the economy and there is no private sector involvement.

(2) The economic activities are handled by 'Centralized Planning Committee' CPC.

(3) CPC follows very strict rules and regulations in controlling economic activities and therefore, they are known as "Bureaucrats"

(4) There is no consumer sovereignty. Accordingly consumers will not be able to purchase all the products they like.

(5) It is generally believed that CPC will distribute income equally and therefore, there will not be disparity among members of the society.

(6) CPC's effort will be to satisfy the needs of people at the most basic level.

(7) It is expected that the environment will be protected.

(8) CPC will charge a nominal profit to collect funds for the following purposes:

- Research and development expenses
- National Defense expenses
- Education expenses
- Healthcare expenses

(9) Competitive markets are absent

(10) There is no price mechanism

(11) There if no profit motive

(05 marks)

(Total 10 marks)

Suggested Answers to Question Three:

| |
|--|
| Chapter 02 - Consumer behavior and the Market |
|--|

(a) (i) $Q_d = 1500 - 6p$
 $Q_s = -100 + 2p$

$$\begin{aligned} Q_d &= Q_s \text{ at the equilibrium} \\ 1500 - 6p &= -100 + 2p \\ 1600 &= 8p \\ 1600/8 &= p \\ \mathbf{200} &= \mathbf{P} \end{aligned}$$

Equilibrium Price = Rs. 200/-

P = 200 is substituted to the Qd equation,

$$\begin{aligned} Q_d &= 1500 - 6p \\ Q_d &= 1500 - (6 \times 200) \\ Q_d &= 1500 - 1200 \\ \mathbf{Q_d} &= \mathbf{300} \end{aligned}$$

Equilibrium Quantity = 300 Units

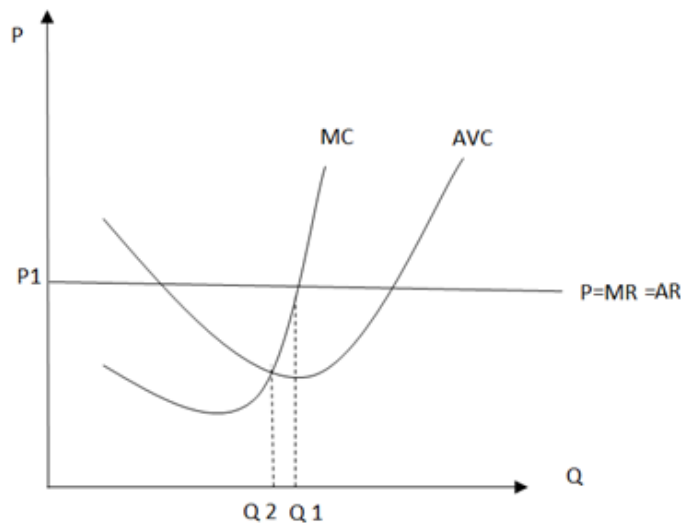
(03 marks)

- (ii) If the consumer's income increases, the market demand would be increased. When consumer's income increases, they purchase more quantity from the product as a result of increase in purchasing power.

This will shift the demand curve to the right hand side and there will be an excess demand. Consequently equilibrium price and quantity will increase.

(02 marks)

(b)



Profit is maximized when the marginal revenue equals to marginal cost. When this occurs the selling price of the product will be higher than the average cost.

(05 marks)

(Total 10 marks)

Suggested Answers to Question Four:

Chapter 04 - Role of government within a market system

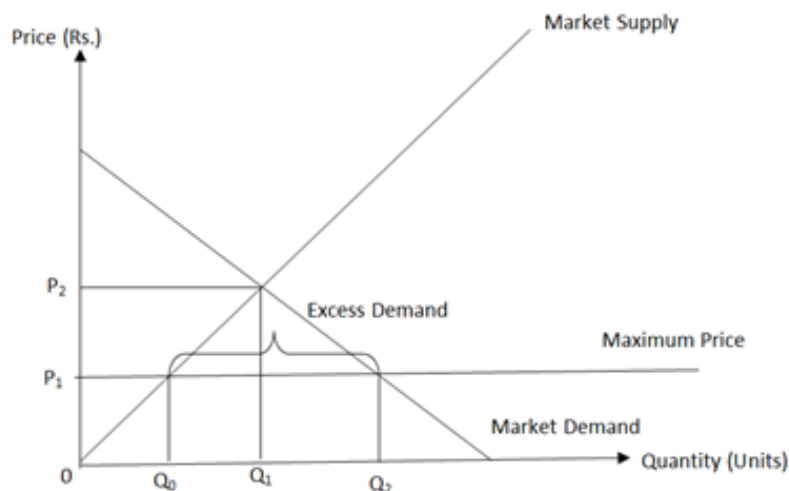
(a) **Maximum Price (Price Ceiling)**

This is a legal price imposed by the government below the equilibrium price of a product or service so as to protect consumers.

Any price above the maximum price is illegal and known as black market price.

The main economic consequence of maximum price policy is excess demand or shortage in the market and other adverse results are emerged due to shortage of goods in the market.

Maximum price policy can be illustrated as follows,

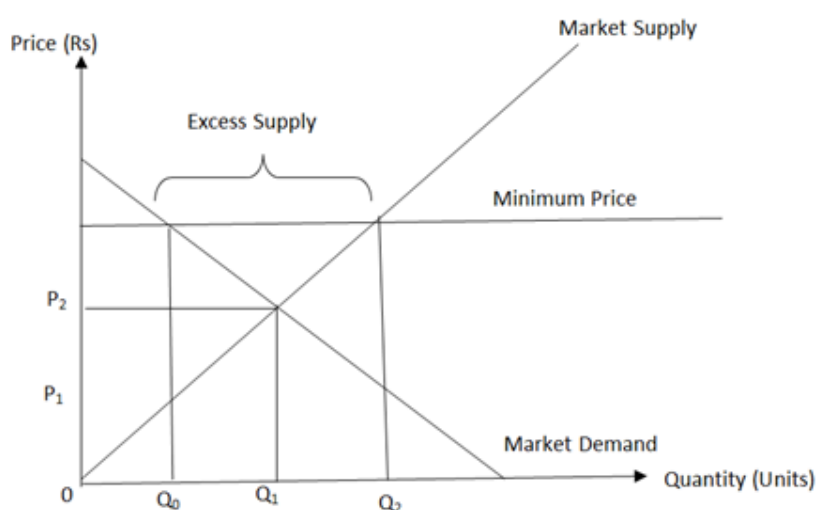


Minimum Price (Price Floor)

This is a price imposed by the government above the equilibrium price of a product or service so as to encourage producers. Producers are entitled to sell their products below or above the minimum price as it is not considered as a legal price.

When the government considers that the price which is determined by market forces of demand and supply is unfair for the producers, a minimum price is imposed. It is set above the equilibrium price.

The main economic consequence of minimum price policy is excess supply or surplus in the market and other adverse results are emerged due to surplus of goods in the market. Minimum price policy can be illustrated as follows,



(b) Consequences for a country having a budget deficit in the government budget

(1) **Financing a deficit:**

A budget deficit has to be financed and the issue of new government debt to domestic or overseas investors can do this. But it may be that if the budget deficit rises to a high level, the government may have to offer higher interest rates to attract buyers of government debt. In the long run, higher government borrowing today may mean that taxes will have to rise in the future.

(2) **Continuously increasing government debt:**

In the long run, a high level of government borrowing adds to the accumulated Public Debt. This means that the Government has to spend more each year in debt-interest payments to holders of government bonds and other securities. There is an opportunity cost involved here because interest payments might be used in more productive ways, for example an increase in spending on health services. It also represents a transfer of income from people and businesses that pay taxes to those who hold government debt and cause a redistribution of income and wealth in the economy.

(3) **Wasteful public spending:**

Many economists do not agree for high level of government spending. They believe that a rising share of GDP taken by the state sector has a negative effect on the growth of the private sector of the economy. They concern about the benefits of higher spending believing that the

scale of waste in the public sector is high – money that would be better off being used by the private sector.

(4) **Reducing welfare expenses done by the government:**

It affects to cut down the welfare expenditure of the country and as well as government should increase tax revenue of the country.

(5) **Decrease in economy growth:**

Continuous budget deficit results in slowed economic growth.

(6) **Increase in inflation:**

Due to devaluation of foreign currency, prices of goods and services increase. It affects to increase in inflation.

(7) **Devaluation of domestic currency against US dollar:**

The government has to use foreign reserve to settle the borrowing. As a result foreign reserves decrease and Sri Lankan rupees will devalue against US dollar.

(06 marks)

(Total 10 marks)

Suggested Answers to Question Five:

| |
|---|
| Chapter 05 - Money and price level |
|---|

(a) (i) **Functions of money**

Functions of money can be explained as follows,

Medium of exchange - The most significant function of money is as a medium of exchange in order to facilitate transactions. If there is no money, all business transactions would have to be carried out through barter system. Money allows economic agents to exchange goods without the need for barter.

Store of value - Individuals can choose to forgo consumption in the current time period and save to increase their spending power in the future. They are more likely to do this when there is confidence that money will hold its value. Inflation has the effect of reducing the internal purchasing power of money.

Unit of account - Money as a common unit of account enables us to compare the relative prices of goods and services in rupees and cents. Changes in relative prices cause switches in demand as consumers respond to the incentive of lower prices for some goods and services.

Standard of deferred payment - This allows payment for goods and services consumed today in a future time period, for example, the mortgage on a house or a loan to purchase a car.

(03 marks)

-
- (ii) A relationship between the price level and the value of money is that as the price level goes up the value of money goes down. The value of money refers to what a unit of money can buy, whereas, the price level refers to the average of all of the prices of goods and services in a given economy as the price level increases over time, the value of money decreases.

(03 marks)

| |
|---|
| Chapter 08 - International Trade |
|---|

(b) (i) **Protectionism**

Protectionism is the economic policy of protecting domestic industries against foreign competition through tariff and non-tariff barriers to international trade. It includes tariffs on imports, restrictive quotas and various government regulations to discourage imports

(02 marks)

(ii) **Advantages of Protectionism**

- Protects domestic producers from extra competition from foreign countries
- Helps new businesses (infant industries) of the economy to develop before they face competition.
- Helps to protect economy's job. (protects local employments)
- Prevents foreign countries "dumping" lots of cheap imports into the economy.
- Prevents imports of harmful goods.
- Reducing imports to improve the balance of payment position.

(02 marks)

(Total 10 marks)

End of Section B

A compulsory question.

(Total 20 marks)

Suggested Answers to Question Six:

Chapter 06 - Banking and Monetary Policy

(A) (a) **Qualitative Controls**

- Moral suasion
- Fixing maturity periods for commercial bank credit
- Portfolio ceilings
- Provision for refinancing facilities
- Fixing selective interest rate

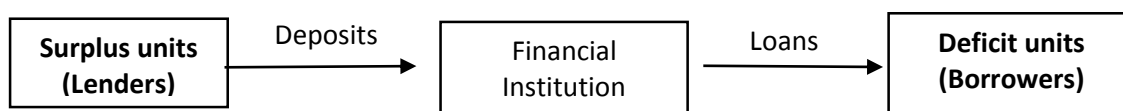
(03 marks)

(b) **Financial intermediation**

Financial intermediation is the process of transferring funds or finance in between surplus parties and deficit parties in the financial system. Financial intermediation is done by financial institutions such as commercial banks, other banks, finance companies etc.

In other words commercial banks accept deposits and make loans and generate a profit from the difference in the interest rate paid to depositors and charged from borrowers. The process performed by banks of taking in funds from a depositors and then lending them out to a borrower is known as financial intermediation.

The intermediation can be illustrated as follows,



(03 marks)

| |
|--|
| Chapter 07 - Macro economy and Business environment |
|--|

(B) (a) **Gross Value Added (GVA) at basic price:**

| Item | Rs.(Millions) |
|--|----------------------|
| Agriculture, Forestry & Fishing | 10,000 |
| Mining and quarrying, manufacturing, electricity & water and other industries | 7,500 |
| Construction | 20,000 |
| Wholesale and retail trade, transportation, storage, accommodation and food service activities | 2,500 |
| Information and communication services | 23,000 |
| Financial and insurance services | 2,500 |
| Real estate activities including ownership of dwelling | 4,550 |
| Professional, Scientific, Technical, Administration and Support service activities | 3,575 |
| Public administration, Defense , Education, Human health and social work activities | 15,000 |
| Other services | 5,600 |
| Gross Value Added (GVA) basic price | 94,225 |

(06 marks)

(b) **Gross Domestic Product (GDP) at market price**

| | |
|---|---------------|
| Gross Value Added (GVA) at basic price | 94,225 |
| Add: Tax on Products | 5,600 |
| Less : Subsidies on products | (3,250) |
| Gross Domestic Product (GDP) at market price | 96,575 |

(04 marks)

(c)

| |
|---|
| Chapter 09 - Economic Growth and Development |
|---|

Difference between Economic Development and Sustainable Development

Economic development is the overall improvement in the entire social system along with the increase in the production in goods and services. Sustainable development is the development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

(04 marks)

(Total 20 marks)

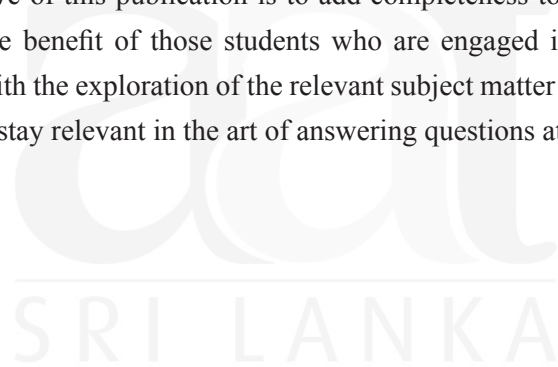
End of Section C

Notice :

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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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