



**Association of Accounting Technicians of Sri Lanka**

**Level I Examination – January 2021**

**Suggested Answers**

**(103) ECONOMICS (ECN)**

**Association of Accounting Technicians of Sri Lanka**

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*Suggested Answers to Question One:*

**Question No    Answer**

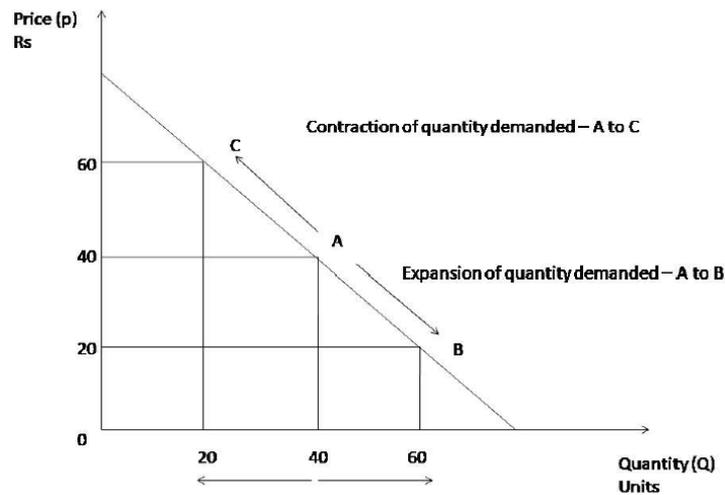
1.1	(2)
1.2	(3)
1.3	(3)
1.4	(4)
1.5	(4)
1.6	(1)
1.7	(2)
1.8	(1)
1.9	(1)
1.10	(2)
1.11	Marginal Cost
1.12	Right
1.13	False
1.14	True
1.15	False



**1.16 Factors that shift the supply curve to left**

- Increase in the price of related goods.
- Increase in the price of factor inputs used in the production.
- Availability of outdated, obsolete technology.
- Decline in the number of suppliers in the market.
- Imposition or increasing the tax imposed on producers by the government.
- Removal of subsidies to the producers by the government.
- Expectations of producers that the price of the good will increase in the future.

**1.17** “Change in Quantity of Demand refers to the increase or decrease in quantity of demand as a result of change in price while all the other factors that influence the demand remain constant”. This can be presented by moving a point of demand curve along the curve.



**1.18 Factors that cause increasing returns to scale**

- Indivisibility or lumpiness of factors of production.
- Specialization of factors of production through division of labour.
- Economical use of sophisticated, technologically advanced machineries.
- Due to expenses that has to be incurred only once.

**1.19 Marginal Revenue**

When the output is increased by one unit, the additional to the total revenue is defined as marginal revenue.

$$\text{Marginal Revenue} = \frac{\text{Change in Total revenue}}{\text{Change in Output}}$$

**1.20 Ways in which government intervene the market**

- Imposition of taxes.
- Providence of subsidies.
- Introduction of price controls.
  - Introduction of maximum legal price.
  - Introduction of minimum legal price.
- Stabilization of price

*(02 marks each, Total 40 marks)*

***Suggested Answers to Question Two:******Chapter 1-Economic Concepts and Systems related to Business Environment*****(a) Main Economic Resource / Factors of Production**

Land  
Labour  
Capital  
Entrepreneurship

**(02 Marks)**

**(b) Main characteristics of a market economic system**

- Fundamental economic problems are solved through the price mechanism.
- Properties are owned by the private sector.
- Existence of a private entrepreneurial system.
- Minimal interference of the government.
- Existence of consumer sovereignty.
- Existence of competition in the market.
- Existence of freedom of choice.

**(04 Marks)**

**(c)**

- (i) Choice** is the selection of the best option out of all the alternatives available. Therefore, deciding for what purpose the scarce resources with alternative uses to be made use of.

**(02 Marks)**

- (ii) Production possibility curve is constructed based on the following assumptions.**

- Only two goods can be produced in the economy.
- Amount of available resources is fixed during the period under consideration.
- Technology is constant.
- All available resources are used in full and to the maximum efficiency.

**(02 Marks)**

**(Total 10 Marks)**

***Suggested Answers to Question Three:***

***Chapter 2- Demand, Supply, Equilibrium and Ways of Government Intervention***

(a) At equilibrium;  $Q_d = Q_s$

$$Q_d = 3,600 - 7P$$

$$Q_s = -200 + P$$

$$3,600 - 7P = -200 + P$$

$$3,800 = 8P$$

$$P = 3,800/8$$

$$P = 475$$

**Equilibrium Price – Rs. 475/-**

P=475/- is substituted to the  $Q_d$  equation,

$$Q_d = 3,600 - 7p$$

$$Q_d = 3,600 - (7 \times 475)$$

$$Q_d = 3,600 - 3,325$$

$$Q_d = 275$$

**Equilibrium Quantity – 275 Units**

**(04 Marks)**

(b)

***Chapter 3- Behavior of Production Process and Different Market Structures***

**Short-run** production refers to the production process in which goods and services are produced by using both fixed and variable inputs. This is the time in which the firm is not able to change its fixed factors of production. There are fixed and variable factors in the short-run as a result total cost of production includes both fixed cost and variable cost. The cost and production behavior in short run depends on the Law of Diminishing Marginal Returns.

**Long-run** production refers to the production process in which goods and services are produced by using only variable inputs. This is the time taken by the firm to change its fixed factors of production. There are only variable factors in the short-run as a result total cost of production includes only variable cost. The cost and production behavior in long-run depends on the Law of Returns to Scale.

**(04 Marks)**

(c)

***Chapter 3- Behavior of Production Process and Different Market Structures***

The following characteristics could be found in monopolistic Competition

- Existence of Large number of firms in the industry
- Each firm in the industry offering a differentiated product
- Free entry into the market and free exit from the market
- Firms in the industry face a high elastic downward sloping demand curve
- Perfect mobility of factors of production
- Monopolistically Competitive firms make normal profit or in other words zero economic profit in the long-run
- High advertising

**(02 Marks)**

**(Total 10 Marks)**

## **Suggested Answers to Question Four:**

### **Chapter 5- Financial System, Money and General Price Level**

#### **(a) The functions of a commercial bank**

- Accepting deposits
- Lending money
- Collection of cheques and bills
- Issuing letter of credit
- Issuing letters of references
- Issuing travellers cheques
- Safety locker facility
- Electronic fund transfers (EFT)
- Automated Teller Machine (ATM)
- Issuing Debit Cards and Credit Cards
- Providing leasing facility
- Debt factoring services

**(04 Marks)**

- (b)** Profitability and Liquidity are the main objectives of a commercial bank. Commercial bank is a business entity which is driven by profitability by borrowing and lending. However, commercial banks are main stakeholders are the financial system of a country which directly influence the money supply. Survival of banks depends on the confidence that people have in the financial system, which requires bank to maintain sufficient liquid funds to meet customer demand. Profitability and liquidity are negatively interrelated to each other where high liquid assets generate less profit and vice versa. Commercial banks achieve both objectives by managing their asset structure. Low liquid assets are used to achieve the profitability while high liquid assets are used to protect the liquidity. Therefore, commercial banks should maintain a balance between these two.

**(04 Marks)**

#### **(c) Inflation is caused by two main reasons,**

1. Increase in aggregate demand (demand full inflation).
2. Increase in cost of production (cost push inflation)

**(02 Marks)**

**(Total 10 Marks)**

## **Suggested Answers to Question Five:**

### **Chapter 6- International Trade and Foreign Exchange Market**

#### **(a) Disadvantages of International Trade**

- Inflow of unwanted and unsuitable goods into the country.
- Too much of specialization may bring about an adverse impact on the country.
- A country may have to heavily dependent on other countries.
- Domestic industries are exposed to foreign competition and “dumping” of cheap foreign products and this may cause unemployment if these industries are unable to compete with cheaper imports.

**(02 Marks)**

**(b) Advantages of protectionism.**

- The importance in the national security
- Protect domestic producers from extra competition from foreign products.
- Help new business (infant industries) of the economy to develop before they face competition.
- Increase the utilization of domestic resources
- Diversification of industry
- Helps to protect economy's job (protect local employments).
- Prevent foreign countries dumping lots of cheap imports into the country by imposing tariffs
- Prevent imports of harmful goods.
- Reducing imports to improve balance of payment account.

**(02 Marks)**

**(c) Economic consequences of devaluation of currency.**

1. **Prices on imports will increase** – There is a disadvantage to importers due to the increase in price with devaluation of rupee against US Dollar. Therefore, they have to pay more on imports and ultimately the burden passes to the customer. As a result prices of goods available in the market will increase.
2. **Revenue on export will increase** – When rupee depreciates against the US\$, makes exports more competitive and cheaper for foreign buyers. This will increase the demand for exports and income on exports will increase.
3. **Increase in inflation** – Due to the devaluation of rupee against US Dollar, it will result in increase in the inflation since prices of raw materials and consumer goods increase.
4. **Deficit in balance of payment account**  
Sri Lanka's export revenue is lessor than imports. When prices of import goods are increased, it affects in increasing the deficit of balance of payment account. Therefore, the government needs to obtain more borrowings to settle the deficit of balance of account.
5. **The government has to be paid more as interest on foreign loans**  
If the rupee value is devalued, the government has to be paid more as capital repayment and loan interest on foreign borrowings. As a result the government has to reduce capital investment and should take more borrowings to settle the loans and interest.

**6. Reducing foreign direct investment**

Foreign investors do not like to invest in Sri Lanka due to devaluation of rupee. Direct investment is the main factor for economic development of the government.

**7. Reducing the cost of living of the people**

Due to these factors, cost of living will be reduced by the people of Sri Lanka, Real value of money is less.

*(06 Marks)*  
*(Total 10 Marks)*

***End of Section B***



**Suggested Answers to Question Six:****Chapter 4 – National Accounting and Role of the Government**

(A)

<b>(a) Gross Domestic Expenditure (GDE) at Market Price</b>	<b>(Rs. million)</b>
Private consumption expenditure	= 600
Government consumption expenditure	= 500
Gross domestic fixed capital formation	= 400
Changes in stock	= <u>200</u>
<b>Gross Domestic Expenditure (GDE) at market price</b>	= <b><u>1,700</u></b>

**(05 Marks)**

**(b) Gross Domestic Product (GDP) at Market Price. (Rs. million)**

Gross Domestic Expenditure (GDE) at market price	= 1,700
Add: Export	= 400
Less: Imports	= <u>(250)</u>
<b>Gross Domestic Product (GDP) at market price</b>	= <b><u>1,850</u></b>

**(03 Marks)**

**(c) Gross National Income (GNI) at Market Price. (Rs. million)**

Gross Domestic Product (GDP) at Market Price.	= 1,850
Net factor Income from abroad (Net foreign primary income)	= <u>(100)</u>
<b>Gross National Income (GNI) at Market Price</b>	= <b><u>1,750</u></b>

**(02 Marks)**

(B)

**(a) The Fiscal Policy** is the policy formulated by the government for the changes made and measures taken in relation to government expenditure, taxation and borrowing to achieve macro-economic goals. The main variables of fiscal policy are Government expenditure and Government revenue. Fiscal policy can be formulated in the form of contractionary policy, expansionary policy, or neutral policy.

**Monetary Policy** is the process which controlling the supply of money , availability of money and cost of money ( interest rate) in order to attain a set of objectives towards the growth and stability of the economy.

**(04 Marks)**

**(b)** A deficit budget is when the state expenditure exceeds state revenue.

Example:

$$\begin{aligned}\text{Budget Deficit} &= \text{Government Revenue} - \text{Government Expenditure} \\ &= \text{Rs.300 million} - \text{Rs.350 Million} \\ &= \textbf{(Rs.50 Million)}\end{aligned}$$

*(02 Marks)*

**(c)**

**(a). Measures used to prevent insufficiency in resource allocation**

- Encouraging consumption of welfare items
- Supply of public goods
- Supply of quasi-public goods
- Restriction of Supply of demerit goods.

*(02 Marks)*

**(b) Reasons for the failure of the government**

- Political selfishness.
- Increase of administrative expenses.
- Avoiding government interference
- Lack of change in with the dynamic business environment.

*(02 Marks)*

*(Total 20 Marks)*

**End of Section C**

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SRI LANKA

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