Association of Accounting Technicians of Sri Lanka

Level I Examination – January 2023

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 (1)

1.3 (3)

1.4 (2)

1.5 (1)

1.6 (2)

1.7 (2)

1.8 (1)

1.9 (3)

1.10 (2)

1.11 Positive

1.12 Monopolistically Competitive

1.13 False

1.14 True

1.15

Microeconomics is a branch of economics that studies the behavior of individual entities. It looks at how these smaller units make decisions when allocating limited resources to producing and selling goods and services in different markets. Microeconomics analyses how the consumers, producers, and workers operate in an economic system when making decisions separately, it simply looks at human choices and resource allocation.

Examples:

- The price of a good is determined by its demand and supply conditions in the market.
- The behavior of consumers.
- The determination of the cost, revenue, and profit of a firm.
- The study of scarcity, choice, allocation of resources, and opportunity cost

Macroeconomics is a branch of economics that looks at the economy from a broader perspective; it is the bird's eye view of the economy. Macroeconomics studies the structure, behavior, and performance of the entire economic system. Each and every sector in the economy, for example, organizations, individuals and economic variables, etc. Jointly determines how the entire economic system functions. Accordingly, the overall behavior of the said economic sectors, the factors that determine such behavior and the problems that arise, and the outcomes that result from such behavior are studied under macroeconomics.

Areas:

- Aggregate output, income, and expenditure
- Inflation, price level, and money supply
- Exchange rate, foreign trade, the balance of payments
- Employment, unemployment, and economic growth
- Economic boom, recession, and decline

1.16

Income effect of a price change refers to change in quantity demanded of a good or service due to change in purchasing power of a consumer resulting from a change in real income because of the change in the price of the given good, while all other factors influencing demand for the same good, including the nominal income of the consumer remain the

same. (Change in quantity demanded of a good, due to the effect of the price change on real income.)

1.17

Choices:

All economies struggle with limited resources and unlimited human wants and desires. Hence, individuals try to satisfy their unlimited wants with limited resources. Economic resources have alternatives. As all these alternatives cannot be achieved at once, the economy, or people, must choose the best option. Hence, creating choices involves choosing how to use scarce resources with alternative uses and what to forgo.

Example: A student having Rs.500/= with him/her, has the following alternative options. Settling his tuition fees, purchasing a calculator, or depositing in a bank account to be considered.

Opportunity Cost:

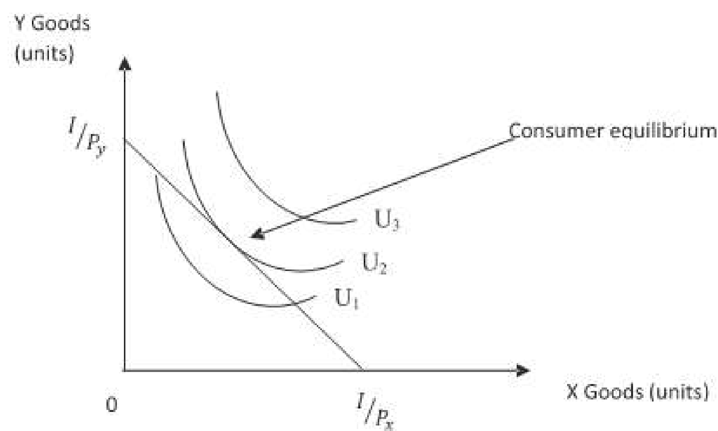
The opportunity cost is the value of the next best alternative when choosing to utilize resources for one purpose. Here it is important to note that the opportunity cost is not the cost of all the alternatives given up when choosing one option, but the cost of only the next best alternative option.

1.18

1. Maintaining economic and price stability
2. Maintaining financial stability
3. Management of the Monetary Policy
4. Management of issuance of currencies
5. Employee' Provident fund Management
6. Public Debt Management
7. Public Debt Management
8. Financial Intelligence
9. Management of Official Foreign Reserves
10. Management of Foreign Exchange Policy
11. Micro Finance and Regional Development
12. Lender of last resort

1.19

Indifference curve is a graph which shows the combination of two goods that gives the person equal satisfaction or equal utility, given his/her budget constraint. According to the indifference curve analysis, the consumer equilibrium is the combination of goods that corresponds with the point at which budget line is just tangent to the highest attainable indifference curve in the indifference map of the given consumer. As this point the slope of the budget line is equal to the slope of the indifference curve.



1.20 Sustainable Development

Enhancing the levels of production while protecting the quality of environment and also ensuring that benefits of development are distributed among the population, a country is able to achieve sustainable development. All aspects of development such as environment, economy and social is the sustainable development.

In other words, Sustainable development can be defined as development that satisfies the requirements of the present without compromising the capability of future generations to fulfil their own requirements.

(02 marks each, Total 40 marks)

End of Section A

Suggested Answers to Question Two:

Chapter 02 - Demand, Supply, Equilibrium and Ways of Government Intervention

(a)

(i) $Qd = 17 - 0.05P$
$Qs = -1 + 0.1P$

$Qd = Qs$; at the Equilibrium

$17 - 0.05P = -1 + 0.1P$
$18 = 0.1P + 0.05P$
$18 = 0.15P$
$\mathbf{120 = P}$

Substituted for the Qd Equation

$Qd = 17 - 0.05P$
$= 17 - (0.05 \times 120)$
$= 17 - 6$
$= \mathbf{11\ (Units)}$

Or

Substituted for the Qs Equation

$Qs = -1 + 0.1P$
$= -1 + (0.1 \times 120)$
$= -1 + 12$
$= \mathbf{11\ (Units)}$

Equilibrium Price = Rs.120
Equilibrium Quantity = 11 (Units)

(04 marks)

(ii) New Supply equation after the unit tax of Rs.30/=

$Qs = -1 + 0.1 (P - 30)$
$= -1 + 0.1P - 3$
$= -4 + 0.1P$

$Qd = 17 - 0.05P$
$Qs = -4 + 0.1P$

$Qd = Qs$; at the Equilibrium

$17 - 0.05P = -4 + 0.1P$
$21 = 0.1P + 0.05P$
$21 = 0.15P$
$\mathbf{140 = P}$

Substituted for the Qd Equation

$$Qd = 17 - 0.05P$$
$$= 17 - (0.05 \times 140)$$
$$= 17 - 7$$
$$= 10 \text{ (Units)}$$

Or

Substituted for the Qs Equation

$$Qs = -4 + 0.1P$$
$$= -4 + (0.1 \times 140)$$
$$= -4 + 14$$
$$= 10 \text{ (Units)}$$

Equilibrium Price = Rs.140

Equilibrium Quantity = 10 (Units)

(03 marks)

(b)

Consumer equilibrium means the point where a consumer maximizes his/her utility given his/her level of income. There are two basic approaches through which economists identify the equilibrium position or in other words the consumption level at which a rational consumer gains the maximum satisfaction in a market.

(03 marks)
(Total 10 marks)

Suggested Answers to Question Three:

Chapter 01- Economic Concepts and Systems related to Business Environment

(a)

Economic Goods

Any good or service for which there is a limitation/scarcity in supply and there is opportunity cost in production and consumption. These goods are produced by utilizing scarce resources and by combining factor inputs.

Examples

- Food
- Clothing
- Shelter
- Buildings
- School Books

Non – Economic Goods

When supply is available, any good that can be consumed without any limitation at zero price. These goods are gifts of nature and available without any human interference. As there is no human interference in providing these goods, no resource cost or opportunity cost is incurred in the production or consumption of these goods.

Examples

- The Sun Light
- Fresh Air
- Water

(04 marks)

Chapter 03 - Behavior of Production process and Different Market Structures

(b)

Quantity	Total Variable Cost (TVC)	Average Variable Cost (AVC)
1	150	**150**
2	250	**125**
3	330	**110**

$$\mathbf{AVC} = \frac{\mathbf{TVC}}{\mathbf{Q}}$$

(03 marks)

(c)

Marginal Cost

The additional cost of producing one more unit of an output is referred to as Marginal cost. This can be derived by dividing change in total cost from change in output.

$$\textbf{Marginal Cost} = \frac{\text{Change Total Cost}}{\text{Change Output}}$$

$$\mathbf{MC} = \frac{\Delta TC}{\Delta Q}$$

Marginal Revenue

Addition to the total revenue, when the output is increased by one more unit is defined as the marginal revenue. This can be derived by dividing the change in total revenue by change in output.

$$\textbf{Marginal Cost} = \frac{\text{Change Total Revenue}}{\text{Change Output}}$$

$$\mathbf{MC} = \frac{\Delta TR}{\Delta Q}$$

(03 marks)
(Total 10 Marks)

Suggested Answers to Question Four:

Chapter 05 - Financial System, Money and General Price Level

(a) Reasons for the use of electronic money

- Its practicality
- Easy and quick settlement attracts customers
- Efficient transaction time
- The simplicity of the payment process
- Safety and security than currency
- International payments can be made
- Can be linked to internet of banks
- Competition among commercial banks

(02 marks)

(b) Reasons that lead to a lower credit rating

Below mentioned Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Challenging domestic financing outlook
- External debt restructuring
- Banking sector faces tight liquidity
- Budget aims for fiscal consolidation
- Political risks weigh on fiscal outlook
- High inflation
- Inability to pay foreign borrowings
- Decrease in foreign reserves
- Inability to earn income through sectors such as tourism lead to narrowed fiscal space
- Debt servicing capacity of the country has been reduced.
- Existing funding support from official sources do not appear sufficient.
- High fiscal deficit in the country.
- Severe economic contraction in the country.

(02 marks)

(c)

In the field of economics, the term "hyperinflation" refers to a situation in which the prices of all goods and services grow uncontrollably over the course of a specific period of time. In

other terms, hyperinflation refers to inflation that occurs at an excessively rapid rate. Below mentioned are the consequences of hyperinflation.

1. Erodes purchasing power

This is inflation's primary and most pervasive effect. An overall rise in prices over time reduces the purchasing power of consumers, since a fixed amount of money will afford progressively less consumption.

2. Reduce Standard of Living

When real money income reduces with the inflation, consumers reduce their essential purchases. It ultimately affects the standard if living of consumers.

3. Raises Interest Rates

Government and central banks use its power to control hyper-inflationary situation in the country by raising interest rate to reduce money supply in the country. It results to pay higher amount as loan interest.

4. Increase savings in short term

Elevated inflation discourages saving, since it erodes the purchasing power if the savings over time. That prospect can encourage consumers to spend and businesses to invest.

5. Devalues the local currency

On foreign exchange markets, hyperinflation rapidly devalues the local currency as its relative worth in contrast to other currencies declines. This circumstance will induce local currency holders to reduce their holdings and switch to more stable foreign currencies.

6. Unnecessarily Tying up cash

In an effort to avoid paying higher prices later on as a result of hyperinflation, individuals often invest in durable commodities such as equipment, machinery, and jewellery. In instances of sustained hyperinflation, people will begin to store perishable items. However, that practice causes a vicious cycle – as prices rise, people accumulate more goods, in turn creating higher demand for goods and further increasing prices. If hyperinflation continues unabated, it nearly always causes a major economic collapse.

(06 marks)

(Total 10 marks)

Suggested Answers to Question Five:

Chapter 06 - International Trade and Foreign Exchange Market

(a) Reasons for demanding dollars

- To pay international university fees / Course fees
- To pay for the imported goods and services from foreign countries
- To travel abroad
- To settle other international transactions
- To purchase assets in foreign countries
- Repayment of foreign loans
- Payment of interest on foreign loans
- To make investments abroad

(02 marks)

(b)
(i)
According to the information given, Country "A" needs lesser amount of labor units in comparison to Country "B" in the production of "X". Therefore, Country "A" has the absolute advantage in the production of "X". (X=Country A)
Country "B" needs the lesser amount of labor unit comparison to Country "A" in the production of "Y". Therefore, Country "B" has the absolute advantage in the production of "Y". (Y = Country B)

(02 marks)

(ii)

	Opportunity Cost, "X"	**Opportunity Cost, "Y"**
A	4/8 = 0.5	8/4 = 2
B	6/3 = 2	3/6 = 0.5

Country – "A" has the comparative advantage in the production of "X" whereas country – "B" has the comparative advantage in the production of "Y".

(04 marks)

(c) Transactions recorded in the balance of payment

- Balance of trade in goods
- Balance of trade in services
- Net primary income (this includes incomes from interest, profits, dividends generated from foreign investments and also migrant remittances i.e. payments from people living and working overseas)
- Net secondary income (this includes annual contributions to world organizations, spending military aid, overseas development aid and etc.)
- Sale / transfer of patents, copyrights, franchise, leases and other transferable contracts and goodwill
- Transfer of ownership of assets
- Foreign direct investments
- Portfolio flows
- Balance of Banking flows

(02 marks)
(Total 10 marks)

End of Section B

Suggested Answers to Question Six:

Chapter 04 - National Accounting and Role of the Government

(A)

(a)

(i) Gross Domestic Expenditure (GDE) at Market Price.

Item	Rs. millions
Private Consumption Expenditure	2,500
Government Consumption Expenditure	5,000
Gross Domestic Fixed Capital Formation	4,500
Changes in Stocks	2,456
Gross Domestic Expenditure (GDE) at Market Price	**14,456**

(05 marks)

(ii) Gross Domestic Product (GDP) at Market Price

Item	Rs. millions
Gross Domestic Expenditure (GDE) at Market Price	14,456
Add: Exports	2,800
Less: Imports	(5,789)
Gross Domestic Product (GDP) at Market Price	**11,467**

(03 marks)

(iii) Gross National Income (GNI) at Market Price

Item	Rs. millions
Gross Domestic Product (GDP) at Market Price	11,467
Add: Net foreign primary income	(50)
Gross National Income (GNI) at Market Price	**11,417**

(02 marks)

(b) Basic Price

When a manufacturer ready to sell the product or service which he/she has manufactured, the price which is relevant for that particular product or service can be identified as basic price. This price should be received from the buyer to the producer. This basic price does not include any levied on the product and includes subsidies received by the manufacturer on the sale. But if any other tax is levied by the manufacturer, other taxes imposed on the product have to be deducted. The cost of transportation is not included in the base price. The base price is involved in the production decision.

(02 marks)

(B) Macro-economic policies (Any two)

1. **Monetary policy**

The Government and the Cental Bank use the monetary policy to determine the size and the rate of money supply as it affects the;

- Rate of Interest Rate
- The Exchange Rate
- Price and Income Level of a Country

The money supply and the interest rate are the main tools of the Monetary policy.

2. **Fiscal policy**

Steps are taken to change the government revenue, government expenditure and government debt through this policy. Decisions taken with regard to government expenditure, taxation and government debts are considered as fiscal policy measures.

3. **Supply side policies**

Supply side policies are designed to enhance the productive capacities of a country thus the Aggregate Supply (AS). These policies are aimed at improving quality and quantity of factors of production and tools such as Privatization, Deregulation and Tax reforms are employed toward this.

4. **Income policy**

Policies used by the government to control economy wide escalation in wage rates and price levels, mainly to curb inflationary pressures in the economy.

5. **Foreign trade policy**

Taking action to influence free international trade is known as foreign trade policy. Taxes and tariffs, export subsidies, import quotas, manipulation of exchange rate are such tools employed towards achieving favorable balance of trade.

6. **Direct controls**

Measures taken by the government to intervene in the free market, policies aimed at controlling ownership and distribution of resources and also price determined through market forces are considered as direct controls.

(04 marks)

(C)

(a) Recurrent expenditure of the government

Except government's expenditure on acquiring real assets used in production processes for more than one year and also on capital transfers all other payments are considered as recurrent expenditure.

(02 marks)

(b) There are three (03) major types of recurrent expenditure;

- Recurrent expenditure on goods and services
- Interest payments
- Recurrent transfers and subsidies

(02 marks)

(Total 20 marks)

End of Section C

Notice:

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