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Association of Accounting Technicians of Sri Lanka

Level I Examination – January 2025

Suggested Answers

(103) ECONOMICS (ECN)

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

Level I Examination – January 2025

(103) ECONOMICS

SUGGESTED ANSWERS

(Total 40 Marks) **SECTION - A**

Suggested Answers to Question One:

Question No	Answer
1.1	(2)
1.2	(4)
1.3	(1)
1.4	(1)
1.5	(2)
1.6	(3)
1.7	(4)
1.8	(1)
1.9	(1)
1.10	(2)
1.11	Scarcity
1.12	Flexible
1.13	True
1.14	False

1.15 Three basic economic problems (Section 1.5.1)

1. What to Produce?
2. How to produce?
3. To Whom to produce?

1.16 Factors that shift the supply curve to the right (Section 2.3.4.2)

1. Decline in the price of related goods.
2. Decline in the price of factor inputs used in the production
3. Advancement in technology.
4. Increase in the number of suppliers in the market.
5. Reduction or removal of the tax imposed on producers by the government.
6. Providence of subsidies to the producers by the government.
7. Expectations of producers that the price of the good will decline in the future

1.17

Short Run Production: The short run in a production process in the time period within which amounts of fixed factors used in the production cannot be changed and changed only variable factors inputs.

Long Run Production: The time necessary to convert fixed production inputs into variable factors considered as the long run production of a firm.

1.18 Characteristics of perfectly competitive (Section 3.6.1)

1. Production of identical goods (Homogenous Products).
2. Large number of buyers and sellers in the market
3. Perfectly Competitive firms are price takers
4. Free entry and exit
5. Perfect Information
6. Perfect mobility of factors of production
7. zero economic profit in the long-run
8. Availability of full information

1.19 Transactions/items recorded in the current account of the Balance of Payment Statement (Section 6.4.2.1)

1. Export and Import of goods (Merchandise Transactions or Visible Trade)
2. Export and Import of Services(Invisible Trade)
3. Primary Income (The net flow of Income receipts and payments to and from abroad
4. Secondary Income
5. Trade and service

1.20 Economic development (Section 7.2)

Economic development means the quantitative and qualitative improvement of all spears of human life, more importantly economic, political, social and cultural spears and the development is a multidimensional process.

Economic Development is an evolutionary process of economic growth. What this implies is the economic development reflects the changes of the economic structure that occurs along economic growth.

(02 marks each, Total 40 marks)

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End of Section A

Suggested Answers to Question Two:

(a) Main characteristics of a market economic system (Section 1.5.1.2)

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

(03 marks)

(b)
(i) Market equilibrium (Section 2.4)

Qd = 250 – 10p
Qs = -50 +15p

Price (Rs.)	Qd(Units)	Qs (Units)
2	230	-20
4	210	10
6	190	40
8	170	70
10	150	100
12	**130**	**130**
14	110	160

Equilibrium Price Rs.12
Equilibrium Quantity 130 units

(04 marks)

(ii) Consumer's Surplus (Section 2.8.1)

$$\text{Consumer Surplus} = \frac{\begin{array}{c}\text{Maximum price at which the commodity}\\ \text{is sold inthe market} - \text{Equilibrium Price}\end{array}}{2} \text{X Equilibrium Quantity}$$

Consumer Surplus $= \frac{(25 - 12)}{2} \times 130$

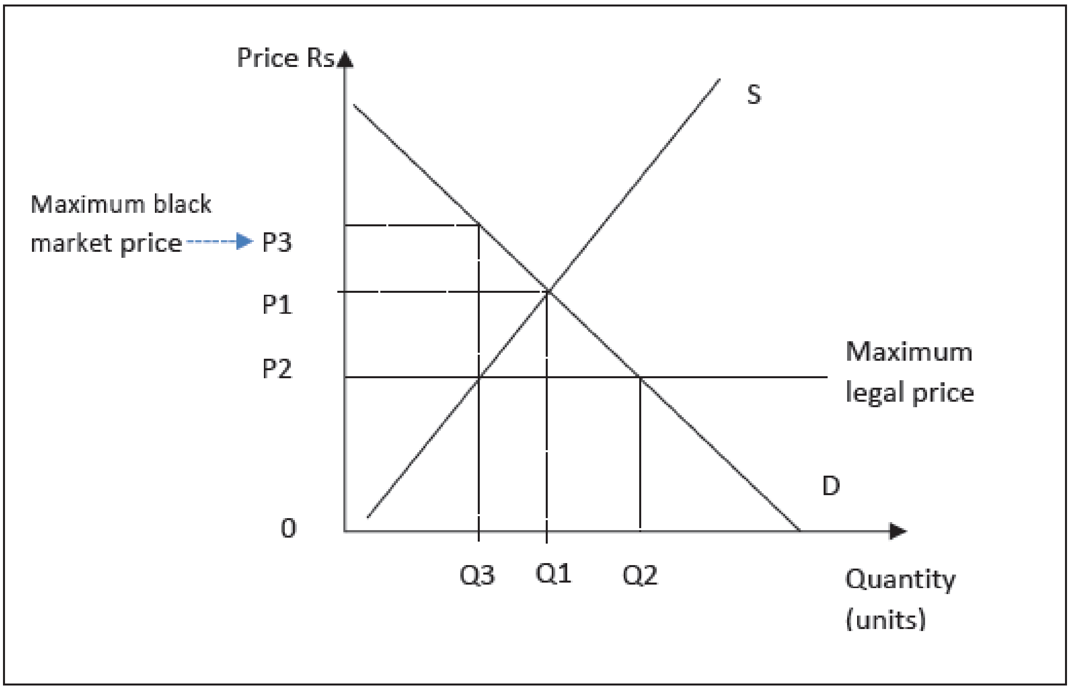
$= 845$

(03 marks)
(Total 10 marks)

Suggested Answers to Question Three:

(a) Economic consequences of imposing Maximum price (Section 2.10, Page no 59)

When the government think that market equilibrium is unfair for consumers to give them fairness the legal price decided by the government is called maximum price.



- Because of the maximum price control, the quantity demand increase from Q1 to Q2 and quantity supplied decrease from Q1 to Q3.
- **This creates an excess demand (shortage) that is equivalent to Q2 – Q3.**
- When a shortage of a good exists, a tendency prevails in a market to shift towards the equilibrium position. Selling the good at a price higher than the legally determined price is considered as selling at a black market price.
- Government should take steps to remove the excess demand
    - Importing
    - Providing incentives for the producers
    - Rationing

- The maximum legal price is imposed when the government is concerned about the wellbeing of consumers and therefore after the imposition of the maximum price, the consumer surplus increases and the producer surplus decreases. However there will be a reduction in the amount of goods or services exchanged in a market after the introduction of the legal price and this will reduce the overall surplus in the economy. This reduction in the surplus is referred to as the welfare loss or the social cost.

(06 marks)

(b) Accounting Profit and Economic Profit (Section 3.2)

Revenue for the firm = Selling price X No. of units sold

= Rs. 50 X 1,000 Units

= Rs. 50,000

Direct Cost (Rs)			Indirect Cost (Rs)		
Raw material	=	5,000	Economic depreciation	=	1,200
Direct wages	=	500			
Other direct cost	=	750			
Total Direct Cost	**=**	**6,250**	**Total indirect cost**	**=**	**1,200**

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Accounting Profit = Total Revenue – Direct cost

Total Revenue	=	Rs. 50,000
Total Direct Cost	=	Rs. 6,250
Accounting Profit	**=**	**Rs. 43,750**

Economic Profit = Total Revenue – (Direct cost + Indirect cost)

Total Revenue	=	Rs. 50,000
Total Direct Cost	=	(Rs. 6,250)
Total indirect cost	=	(Rs 1,200)
Economic Profit	**=**	**Rs. 42,550**

(04 marks)
(Total 10 Marks)

Suggested Answers to Question Four:

(a) Difference between Narrow Money Supply and broad money supply (Section 5.2.5)

Narrow Money Supply (M1)

This includes the money held for transaction motive and money which facilitates Medium of Exchange Function.

$$\mathbf{M1 = CP + DD_P}$$

Where,

M1 = Narrow money supply

Cp = Currency held by the public

DDp = Demand deposits held by the public at commercial banks

Broad Money Supply (M2)

This definition includes all items mentioned in Narrow Money Supply and Money held for Precautionary Motive and Money which facilitates the Store of Value Function.

$$\mathbf{M2 = M1 + TSDp}$$

Where

M2 = Broad in only supply

M1 = Narrow Money Supply

TSDCP = Time and saving deposits held by the public at commercial banks

(03 marks)

(b)

(i) Electronic Money (Section 5.1.5.5)

Electronic Money refers to money or scrip which is exchanged only electronically. Typically, this involves use of computer network, the internet and digital stored value systems. Electronic Funds transfer (EFT) and direct deposits are examples of electronic money and widely used in modern E banking and Easy Cash systems.

Types of Electronic Money:

- Stored-Value Cards (Prepaid Cards) – Examples: Gift cards, transit cards, and prepaid debit cards.
- Digital Wallets (E-Wallets) – Examples: PayPal, Apple Pay, Google Pay, and Venmo.
- Cryptocurrencies – Examples: Bitcoin, Ethereum, and stablecoins.

- Central Bank Digital Currencies (CBDCs) – Government-backed digital currencies issued by central banks.
- Mobile Money – Examples: M-Pesa, Alipay, and WeChat Pay**.**

(02 marks)

(ii) Reasons for use of electronic money (Section 5.1.5.5, Page no. 133)

i. Easy and quick settlement attracts customers.
ii. International payments can be made.
iii. Safer than currency.
iv. Can be linked to intranet of Banks.
v. Competition among commercial institutions
vi. Speed is high
vii. Less transaction cost
viii. Traceability

(03 marks)

(c) Quantitative instruments in monetary policy (Section 5.5.1.1)

i Bank rate policy
ii Reserve Rate policy
iii Open Market Operations(OMO)

(02 marks)
(Total 10 marks)

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Suggested Answers to Question Five:

(a)
(i) Economic effect of inflation (Page no 149)

1. Unfavorable to savers - Inflation can reduce the value of savings as price levels go up due to the inflation. Interest rate return may not cover the cost of inflation. Investors savings will loose purchasing power, as the savings accounts will not grow in line with the inflation.

2. Favorable to creditors but unfavorable to debtors - Lenders are hurt by unanticipated inflation because the money they receive back has less purchasing power than the initial value. Borrower benefits from unanticipated inflation because the money he pay back is worth less than the money he borrowed.

3. **Distorts the decision making process in the economy -** Inflation reduces the spending power of consumers. As prices quickly rise, individuals have less discretionary income & tend to spend less money on luxury products. Price becomes the leading factor in decision making of consumers. Inflation can lead to distortions by changing the price levels of commodities and services.

4. **Unfavorable distribution of income -** Inflation brings about the shifts in distribution of real income from those whose money income are relativity inflexible to those whose money income are relatively flexible. Poor and middles classes suffer because their wages and salaries are more less fixed, but of the commodities prices are continued to rise.

5. **Increase in absolute poverty -** The problem of poverty is aggravated when the prices of commodities increase Inflation is therefore considered as cruelest tax on the poor. When inflation increases, the prices of goods and services also increase but the nominal wage stay the same. People can buy fewer things with same amount of money leads to increase absolute poverty.

6. **Lay obstacles for export competitiveness -** High inflation will increase the cost of production and prices also may rise reducing competitiveness. Higher cost can have substantial impact on the competitiveness of exports in international trade environment. Demand for products or services will be lesser in other countries resulting in less exports.

7. **Increase in cost of living -** Increase in inflation result in increasing the overall cost of living and lowering the purchasing power. If wages are not increasing to match the increase in cost of goods and services the value of consumer's currency will decrease. Rising prices hit middle class hard and lower paid even harder.

8. **Depreciation of currency -** In general inflation tends to devalue a currency, since inflation can be equated with a decrease in a currency's buying power. As a result countries experiencing high inflation tend to see their currencies get weaken relative to other currencies.

(04 marks)

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(ii) Steps to be taken by a country to reduce inflation (Section 5.12)

i Limit the growth in aggregate demand

ii Accelerate the growth in aggregate Supply

iii Remove the barriers in the efficient distribution of resources.

iv Decrease government expenditure.

v Monetary policy.

vi Control of the money supply.

vii Fiscal policy.

(02 marks)

b.

Comparative advantage theory (Section 6.1.2.2)

In order to determine the comparative advantage, the opportunity cost of production of each product should be calculated

Country	The opportunity cost of producing Product Onion	The opportunity cost of producing Product Potatoes
India	9/ 18= 0.5	18/9= 2
Pakistan	4 /2 = 2	2 / 4= 0.5

According to the table given above India has the lowest opportunity cost of producing Onion and Pakistan has the lowest opportunity cost of producing Potatoes.

- **India** has the comparative advantage of producing **Onion**
- **Pakistan** has the comparative advantage of producing **Potatoes**

(04 marks)
(Total 10 marks)

End of Section B

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Suggested Answers to Question Six:

(A) Macroeconomic policies (Section 4.1.1)

Monetary Policy

The Central Bank uses the monetary policy to achieve macroeconomic objectives. The money supply and the interest rate are the main tools of the monetary policy.

Fiscal policy

The Government uses the fiscaly policy to achieve macroeconomic objectives. 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.

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 towards this.

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Foreign Trade Policy

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

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.

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.

(04 marks)

(B) (National Income Section 4.4.6 page 107**)**

(a)

	Item		Rs. million
1.	Compensation of employees	=	50,000
2.	Gross Operating Surplus	=	25,000
3.	Mixed Income	=	10,000
4.	Other Taxes less Subsidies on Production	=	5,000
	Gross Value Added (GVA) at Basic price 1+2+3+4	=	**90,000**

(05 marks)

(b)

Gross Domestic Product(GDP) at Market Price

5.	Gross Value Added (GVA) at Basic price	=	90,000
6.	Net Taxes on production and Imports	=	4,500
	Gross Domestic Product (GDP) at Market Price **(5+6)**	=	**94,500**

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(*02 marks*)

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

7.	*Gross Domestic Product(GDP) at Market Price*	=	94,500
8.	Net Foreign Primary Income	=	15,000
9	***Gross National Income (GNI) at Market Price*** **(7+8)**	=	**109,500**

(02 marks)

(B) Difference between Direct Tax and Indirect Tax (Section 4.10.3)

Direct Tax

The relevant tax, should be paid by the person or entity that is entitled for the direct tax and that cannot be transferred to any other party. In this case the taxable person must bear the burden of the tax.

Examples include income taxes and property taxes.

Indirect Tax

If a person who is legally ordered to pay a tax transfers the tax burden to another person that is referred to as an indirect tax.

Example: VAT

(03 marks)

(d)

Limitations of National income accounts (Page no 102)

i. Non-inclusion of productive activities taking place in informal economy
ii. Non-inclusion of dependent economic activities in national production
iii. Non-inclusion of services provided by housewives in national production
iv. Non-inclusion of interest paid on public debts in national production calculations
v. Non consideration of damage to environment due to production activities
vi. Non consideration of changes of productivity in public services
vii. Inclusion of expenditure on defense and wars under productive activities
viii. Non-inclusion of some consumer goods with long lifespan in national production by categorizing them as investments.

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(04 marks)

(Total 20 marks)

End of Section C

Notice:

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