Association of Accounting Technicians of Sri Lanka

Level I Examination – July 2025

Suggested Answers

(103) ECONOMICS (ECN)

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A publication of the Education and Training Division

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:

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

1.15

Microeconomics studies the behavior of individual units such as consumers, firms, and markets. Macroeconomics looks at the economy as a whole, focusing on aggregates like national income, inflation, and unemployment.

1.16 1. Demand-pull inflation
2. Cost-push inflation

1.17 The Law of Supply

The principal that explains the positive relationship between the price of good and the quantity supplied of that good over a given period of time, when all the factors that determine the supply,Except the price of the own good, remain constant it is referred to as the law of supply.

1.18 Factors that shift the supply curve to the 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- Availability of outdated, obsolete technology.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.

(Expect only two factors)

1.19 Efficiency

Stability

1.20 Open market operations (OMO) refer to the buying and selling of government securities by the central bank to control the money supply and interest rates in the economy.

(02 marks each, Total 40 marks)

End of Section A

Suggested Answers to Question Two:

Chapter One and Three

(a)

- No limitation/scarcity in supply.
- No resource cost.
- Zero opportunity cost.
- Not having a price.
- Gift of nature.
- Not having a clear ownership

(Expect only three characteristics)

(03 marks)

(b)

- Solving of fundamental economic problems through a planning mechanism.
- Existence of state entrepreneurial system.
- The guiding factor of economic activities is the social welfare.
- Nonexistence of consumer sovereignty.
- Existence of fair income distribution.
- Absence of freedom of choice
- Property ownership / means of production lie with the government

(Expect only three characteristics)

(03 marks)

(c)

A condition where there is a single firm in the industry is referred to as a Monopolistic industry. The Monopolistic industry consists of the under mentioned characteristics

- Barriers to Entry – It is extremely difficult for a firm to enter into a Monopolistic industry, there are significant barriers to entry.
- Unique Product/ Product with no close substitutes – The relevant product can only be obtained from a single seller. Therefore the producer gains monopolistic power in the market.
- Only a single firm engages in the production – Only a single firm operates and therefore no competition exists in Monopolistic market. This enables the firm to operate with monopolistic power.
- Availability of imperfect/incomplete information and it is not possible to obtain the information at free cost.
- Price Maker – As the Monopolist has the complete control over the supply, it can determine the price in the market, yet the consumer behavior is beyond the control of the Monopolist. This makes the demand curve faced by the Monopolist downward slopping

(Expect only two characteristics)

(04 marks)

(Total 10 marks)

Suggested Answers to Question Three:

Chapter 02

(a)

(i) $Qd = 2800 - 25p$

$Qs = -200 + 100p$

$2800 - 25p = -200 + 100p$

$-25p - 100P = -200 - 2800$

$-25p = -\frac{-3000}{125}$

$\mathbf{P = Rs. 24}$ Equilibrium Price

By substituting P = Rs.24 to Qd

$\mathrm{Qd} = 2800 - 25\mathrm{p}$

$\mathrm{Qd} = 2800 - 25 \text{ X } 24$

$\mathrm{Qd} = 2800 - 600$

Q =2200 Units Equilibrium Quantity

(04 marks)

(ii) Producer Surplus =

$$\frac{(\text{Equlibrium Price} - \text{Minimum Supply Price})}{2} \text{ X Equlibrium Quantity}$$

$= \frac{24-2}{2}$ X 2200

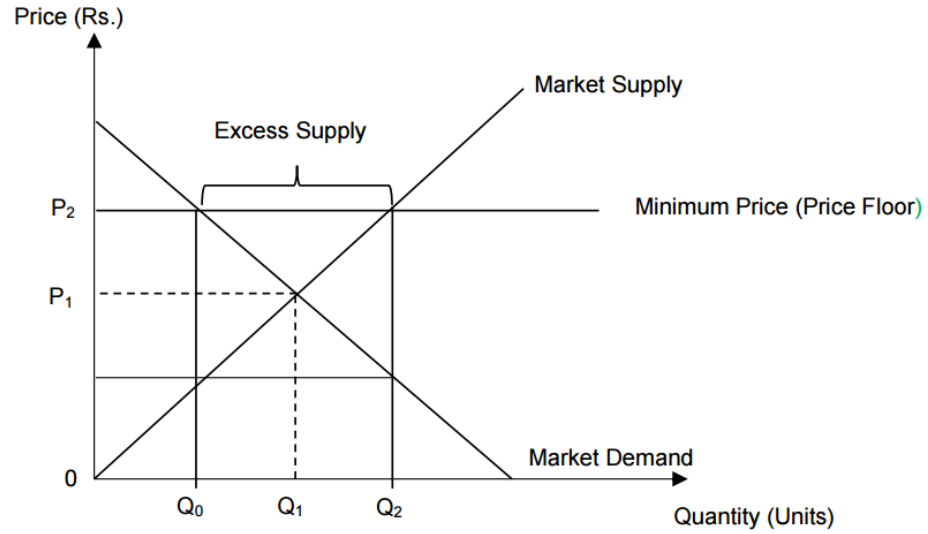
$= \frac{22}{2}$ X 2200

= 11 X 2200

= Rs. 24200

(02 marks)

(b)



The objective of imposing a minimum price is to protect producers by fixing a reasonable price in a way of safeguarding producers. When a minimum legal price is imposed it is illegal to purchase the given item or the given factor input at a price lower than the legally determined price. When a minimum price is imposed, An excess supply will be created in the market. This would in turn create disequilibrium in the market by creating inefficiencies of allocation / distribution of scarce resources of the economy. Therefore, it is important to take necessary measures to eliminate the excess supply in the market. For instance government can;

- Purchase the excess supply and store for future use
- Advise and support the producers to export the excess supply
- Encourage producers to produce substitute products from the excess supply etc.

Further more opportunities may arise intermediaries to purchase the product (Especially from small and medium scale producers) at a lower price and resell it at the floor price. The imposition of minimum legal price reduces the overall economic surplus which will create social cost. ***(04 marks)***

(Total 10 Marks)

Suggested Answers to Question Four:

Chapter Five

(a)

This refers to as anything which could be transferred to money very easily and without any economic losses within a period of time. This type of money also possess very high degree of liquidity

Examples: Savings deposits, fixed deposits, treasury bills

(Expect only an example)

(02 marks)

(b)

Transaction Motive demand for money

It means that holding money for day to day transactions. Household and firms hold a certain amount of money because its usefulness as a generally acceptable medium of exchange. There is a positive relationship between the transaction demand for money and Income. The transaction demand for money rises when income rises or price rises and vice versa.

Precautionary Motive demand for money

A certain amount of money is held by households and firms in order to meet unplanned emergencies such as accidents, unexpected illnesses and unemployment. Precautionary demand relates to unplanned expenditures. People like to hold a certain amount of their wealth in the form of very liquid assets, that is, assets denominated in money terms. The precautionary demand for money will rise with Income.

Speculative Motive demand for money

Speculative Motive for money indicates that changes and expected changes in the interest influence people's decision to hold money in preference to other types of financial assets If rate of interest rises in the market people prefer to invest money in fixed deposits , debentures, bonds and treasury bills, keeping less money with them. When rate of interest falls people prefer to keep money with them. As a result Speculative demand for money and rate of interest maintain a negative relationship. Rate of Interest

(04 marks)

(c)

(i)

$$\boxed{M_1 = C_P + DD_P}$$

Where,

M_1 = Narrow money supply

C_p = Currency held by the public

DD_p = Demand deposits held by the public at commercial banks

$$M_1 = C_P + DD_P$$
$$M_1 = 15{,}600 + 27{,}600$$
$$M_1 = 43{,}200$$

(02 marks)

(ii)

$$M_2 = M_1 + TSD_P$$

Where

M_2 = Broad in only supply

M_1 = Narrow Money Supply

TSD_P = Time and Saving deposits held by the public at commercial banks

$$M_2 = M_1 + TSD_P$$
$$M_2 = 43200 + 14800$$
$$M_2 = 58000$$

(02 marks)

(Total 10 marks)

Suggested Answers to Question Five:

Chapter Six

(a)

A country has an absolute advantage in the production of a product when it is more efficient than any other country in producing it. The economy can produce a greater amount of goods for the same quantity of inputs. Absolute advantage means that fewer resources are needed to produce the same amount of goods and there will be lower costs than other economies.

Simple example of absolute advantage is given below

The number of units of rice and material which can be produced by one unit of labour by Sri Lanka and China are as follows.

Output as per one unit of labour

Country	**Cloths**	**Rice**
Sri Lanka	8	5
China	4	7

Sri Lanka can produce more units of Cloths than China. Sri Lanka can produce 8 units of Cloths while china can produce only 4 units of cloths. Therefore Sri Lanka has the absolute advantage in the production of cloths.

Where the production of rice is concerned China is in a position to produce more rice than Sri Lanka. Sri Lanka can produce only 5 units while china can produce 7 units. Therefore the China has the absolute advantage in the production of rice.

At this situation Sri Lanka has the absolute advantage in the production of materials while China has the absolute advantage in rice.

(03 marks)

(b)

- 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.

(Expect only three disadvantages)

(03 marks)

(c)

1. Imports will become more expensive
   When the local currency depreciates, imports become more expensive in rupees.

2. Increase in import expenditure
   When the Sri Lankan Rupee (LKR) depreciates against USD, it takes more rupees to buy the same amount of foreign goods.
   Example ; If \$1 = Rs.300 (earlier Rs.250), an imported item worth \$100.Now costs Rs.30,000 instead of Rs.25,000.

3. If the domestic production is based on foreign imported inputs, domestic inflation will rise
   Many local industries (e.g., textiles, electronics, fuel, food processing) depend on imported raw materials.
   The higher cost of imports leads to general price increase.This reduces purchasing power.

4. Increase in foreign loan settlements and payments of interest
   If a country has borrowed in foreign currency, depreciation means takes needs more local currency to repay the same debt.
   Example: A \$1 billion loan = Rs. 300 billion (at Rs. 300/\$) instead of Rs. 250 billion earlier. This worsens the government’s debt burden.

5. Improvements in the current account with more exports and lesser imports
   If exports rise and imports fall the current account balance may improve. Also devaluation USD converts to more rupees, boosting remittance inflows local terms.
   This helps to reduce the deficit of trade and service account.

6. Increase revenue in tourism-related industries will result in favorable balance in the services account
   When Sri Lankan rupee devalues, tourism becomes cheaper for foreigners, boosting arrivals and spending. This increases tourism revenue , improves the service account.

7. Due to increased import prices, the demand for imported goods will fall thus increasing the demand for locally produced goods
   Higher import prices discourage consumers from buying foreign products.
   Substitution effect: People shift to domestic alternatives (e.g., local food, clothes, vehicles if available).
   This can stimulate local industries and reduce import dependency.

(Expect Only two impacts)

(04 marks)

(Total 10 marks)

End of Section B

Suggested Answers to Question Six:

Chapter Four

(A)

Producer's Price

Producer's price can be calculated by subtracting the subsidies received by the producer and by adding the taxes directly imposed to the producer, to the basic price. When a unit of a product leaves the factory, the price charged by the producer from the trader is called producer's price.

Producer's Price = Basic Price + Direct taxes on Producer – Production Subsidies (Non- deductible taxes)

Purchaser's Price

The price a consumer actually pays for a product or service is called a purchaser's price. Purchaser's pricing is arranged in conjunction with shipping charges, merchant margins and taxes paid by buyers in addition to the manufacturer's price. This does not include the subsidies received by the manufacturer.

(03 marks)

(B)

(a)

Item	Rs. million
1. Private consumption expenditure	5,000
2. Government consumption expenditure	7,000
3. Gross domestic capital formation	
3.1 Gross domestic fixed capital formation	2,500
3.2 Changes in stock	300
3.3 Changes in value	245
Gross Domestic Expenditure (GDE) at market price (1+2+3)	**15,045**

(06 marks)

(b)

Item	Rs. million
1. Gross Domestic Expenditure (GDE)	15,045
2. Add: Exports of goods and services	4,500
3. Less: Imports of goods and services	(13,000)
Gross Domestic Product (GDP) at market price	**6,545**

(03 marks)

(c)

Item	Rs. million	
1 Gross Domestic Product (GDP) at market price	6,545	
2. Add: Foreign net primary income	500	
Gross National Income (GNI) at market price	**7,045**	***(02 marks)***

(C) Importance of preparing national accounts.

- To assess the economic performance
- To make comparisons with other countries in the world
- To measure economic growth
- To understand the economic structure of the country
- To estimate per capita national income
- To have an understanding about Exposure to resource composition and utilization
- To forecast the behavior of macroeconomic variables
- To identify functional relationships between economic factors. (Expect only 3 importance)

(03 marks)

(D) Causes of Government Failure

1. Lack of Information – Governments may not have complete or accurate information to design effective policies or to take decision on time. *Example:* Setting wrong subsidy levels because true demand or cost data is unavailable.
2. Bureaucracy and Administrative Costs – Policies may be costly to implement and manage, wasting public funds.
3. Political Incentives – Politicians may make decisions with reelection goals prioritizing short term over long term public interest. Leading to poor decision making or misallocating of resources.
   Example: Price controls before elections that cause shortages.
4. Unintended Consequences – Policies may produce negative side effects opposite to their aims.
   Example: Minimum wage laws intended to help workers but could reduce employment if firms decide cut jobs.
5. Regulatory Capture and Corruption – Powerful groups may influence policies in their favor, leading to inequality and inefficiency.
6. Avoiding Government Interference
   Attempts by certain individuals and institutions to hide from government rules and regulations.
7. Firmness in government operations
   Failure to change in government-based policies according to the dynamic environment, can be considered as main weakness. *(Expect only two)*

(03 marks)
(Total 20 marks)

End of Section C

Notice:

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