



Second Term Test - Grade 13 - 2018

Index No : .....

Economics I

Two Hours

Important

- ♦ Answer for all the questions.
- ♦ Select the correct or most suitable answer and write the correct number on the given dotted line.

- Every society faces the problem of choice,
  - because the resources in the society are not efficiently utilized
  - because the available resources are not sufficient to satisfy human wants
  - because there are constantly growing unlimited wants
  - because there are scarcity of resources and the alternative uses of resources
  - because an opportunity cost is created when using the scarce resources (.....)
- The opportunity cost of a certain affair is concerned as,
  - the value of the lost incomes that had to be forgone due to that task.
  - the value of both direct and indirect costs spent on that task.
  - the value of both fixed and variable costs that had to be spent on that task.
  - the value of the owned resources used on that task.
  - the financial cost incurred on that task (.....)
- If the present capital investment is increased in a certain economy operating under a situation of an unemployment,
  - the present consumption level declines.
  - future condition of living will decline.
  - an opportunity cost is not created.
  - the opportunity cost of capital investment increases.
  - the interest rate increases. (.....)
- Increase in investment within the human resource is more important for an economy because,
  - the economy can lead towards a knowledge economy
  - the productivity of labour can be uplifted.
  - the education level can be grown.
  - the labour intensive method can be mostly used.
  - the use of capital instruments can be increased. (.....)

05. A - The government intervention is very low  
 B - private property system  
 C - wage and price is determined by the planning authorities.  
 D - resources are allocated based on the relative price.  
 E - fair distribution of good is emphasized.

The characteristics of a market economic system from the above characteristics include in,

1. A,B and D                                      2. A,B and C                                      3. B,D and E  
 4. A,D and E                                      5. A,C and E                                      (.....)

06. A Capitalist economy, based on the factor price in the factor market and the quantity that is exchanged on that price,

1. allocates available resources among various uses  
 2. chooses the production technology  
 3. Signals about the change in consumers' preference.  
 4. provides solutions for the problem of to whom to produce.  
 5. determines what and what amount to be produced.                                      (.....)

07. According to the factors that was revealed in a consumers survey made on the rice market, quantity demanded for rice has declined and quantity supplied has increased What may cause for this is,

1. declining the expected price of rice  
 2. declining the price of rice  
 3. increase in number of rice suppliers.  
 4. decline in income of rice consumers  
 5. increase in price of rice                                      (.....)

08. The price elasticity of demand for a certain good is - 0.75. At the price of Rs. 50 the sales income of that good is Rs. 4000/= If the price is declined up to Rs. 40/= what is the sales income?

1. Rs. 800                      2. Rs. 3680                      3. Rs. 3500                      4. Rs. 3200                      5. Rs. 4500                      (.....)

09. Why does the consumers' expenditure increase due to the decrease in the market price for bottled drinking water?

1. because the quantity demanded increases when the price of this good declines  
 2. because close substitutes for this good are not available  
 3. because this is a normal good  
 4. because the price - elasticity of demand for this good is elastic  
 5. because this is an essential good                                      (.....)

10. The price elasticity of demand of x is - 2.8 The income elasticity of demand of the x good is -1.2 According to this information x good is a,

1. inferior good                                      2. giffen good  
 3. luxury good                                      4. normal good  
 5. essential good                                      (.....)

11. The market supply curve for a certain good is illustrated by the supply function of  $Q_s = -20 + 2P$ . What is the accurate statement regarding the elasticity of supply from the followings?
1. the price elasticity of supply is inelastic when moving upwards along the curve its value increases.
  2. the price elasticity of supply is inelastic when moving upwards along the curve its value decreases
  3. the price elasticity of supply is elastic and when moving upwards along curve decreases.
  4. the price elasticity of supply is elastic and when moving upwards along curve the value of elasticity increases
  5. the price elasticity of demand is unitary, when moving upwards on the curve its value remains constant (.....)
12. If the market demand curve is elastic, the economic surplus at the equilibrium is only consisted with the consumer surplus when the elasticity of the supply curve is,
1. elastic
  2. perfectly elastic
  3. unitary
  4. inelastic
  5. zero (.....)
13. Market demand and supply schedules for a certain consumer good within a specific time period is as follows.

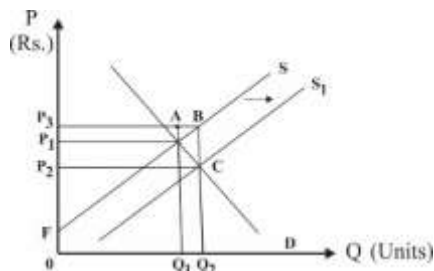
Price of a unit (Rs.)	Quantity demanded (units)	Quantity supplied (Units)
90	400	1000
80	500	900
70	600	800
60	700	700
50	800	600

If government decides to charge a tax of Rs. 20/= on a unit of this good, what is the price after the tax and the government tax revenue?

	Market price after the tax (Rs.)	government tax revenue (Rs.)
1.	70	6000
2.	60	14000
3.	80	18000
4.	80	10000
5.	70	12000

(.....)

14. Following diagram illustrates how the supply curve shifts from  $S$  to  $S_1$  due to the subsidy provided to the milk farmers by the government with the hope of uplifting the domestic milk production.

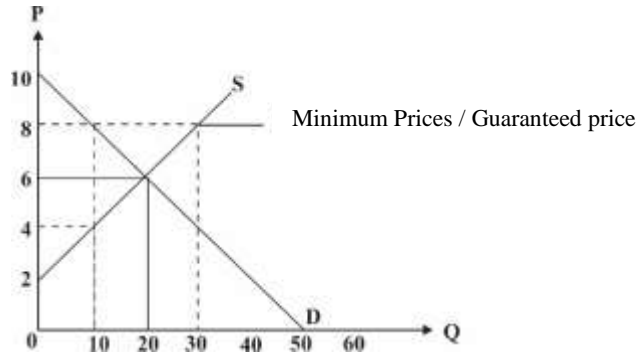


The producers' total revenue after, the subsidy is illustrated by,

1.  $Op_2CQ_2$  area
2.  $P_2P_3BC$  area
3.  $OP_3BQ_2$  area
4.  $OP_3AQ_1$  area
5.  $FP_3B$  area

(.....)

15. The market equilibrium for an agricultural good is illustrated by the following diagram.



The government determines to provide the producers in this market a guaranteed price of Rs. 8 /= per unit. Due to the certification of the minimum price by the price supporting policy of purchasing the excess by the government, what is the amount of producers' surplus and the consumers' surplus?

	<b>Consumers' surplus</b>	<b>producers' surplus</b>
1.	Rs. 90	Rs. 90
2.	Rs. 40	Rs. 90
3.	Rs. 90	Rs. 40
4.	Rs. 10	Rs. 90
5.	Rs. 40	Rs. 10

(.....)

16. The shape of the total cost curve in a firm in the short run is determined according to the,

1. behavior of the average fixed cost
2. manner of changing the technology
3. behavior of the average total cost
4. behavior of the total variable cost
5. behavior of returns to scale

(.....)

17. The average fixed cost constantly declines with the increase of the output of the firm but does not become zero because.

1. the total cost does not change
2. a variable cost exists
3. an average cost exists
4. a marginal cost exists
5. a fixed cost exists

(.....)

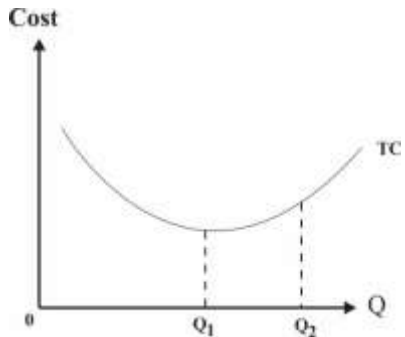
18. The equilibrium of a perfect competitive firm is determined,

1. when the marginal revenue equals to marginal cost at the stage of marginal cost is increasing.
2. when marginal revenue equals to marginal cost at the stage of marginal cost is decreasing.
3. when marginal revenue equals to marginal. cost at the minimum point of marginal cost
4. when marginal revenue equals to marginal cost at the stage of average cost is increasing.
5. when marginal revenue equals to marginal cost at the stage of average cost is decreasing.

(.....)

19. Although the average revenue in the short term exists below the average cost, maintaining the constant production will be meaningful, if the average revenue of the firm,
1. takes a greater value than the average fixed cost.
  2. takes a greater value than the marginal cost.
  3. takes a greater value than the average variable cost.
  4. the total of variable cost and the fixed cost is greater
  5. takes a greater value than the marginal revenue (.....)

20. The following diagram illustrates how the average total cost of the firm is changed when the employment of all the production factors including capital and labour are increased.



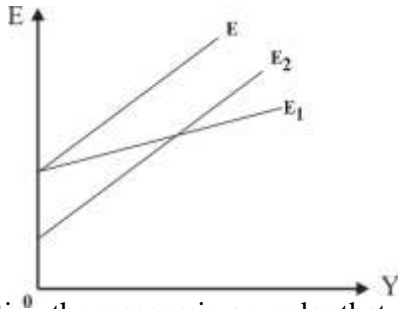
When the firm increases its output from  $OQ_1$  to  $OQ_2$  the diagram illustrates,

1. returns created due to the monopoly power
  2. returns created due to the increase in specialization.
  3. D is economies of scale
  4. increasing economies of scale
  5. increase in productive efficiency. (.....)
21. Choose the answer that includes the different stages of the business cycle in the serial order
1. recession, trough, expansion, peak
  2. recession, peak, expansion, trough
  3. recession, trough, peak, expansion
  4. recession, expansion, trough, peak
  5. recession, expansion, peak, trough (.....)
22. When computing the value of the gross domestic production using the production approach, double - counting errors may occur,
1. by considering the value of old goods
  2. by considering transfers
  3. due to the negative value of the net indirect taxes
  4. by including the value of inter - mediate products
  5. by considering the mone - lateral income (.....)

23. When indirect taxes and capital consumption ( capital depreciation) are added and subsidies are deducted from the total income earned by the factor owners who contributed to create the production within a year in a certain country, this can be computed,
1. the value of the gross domestic product to market price.
  2. the value of the net domestic product to the market price.
  3. the value of the gross national product to the market price.
  4. the value of the net national product to the market price.
  5. the value of the gross national product to the fixed price. (.....)
24. The real wage of a worker working in a production firm depicts that,
1. money is the opportunity cost of the wage
  2. money is the real value of the wage
  3. the value received after deducting the inflationary rate out of the nominal wage
  4. the amount of wage that is earned by him in money.
  5. the total amount of the inflationary rate and the nominal wage (.....)
25. Choose the statement that contains the disposable household income accurately from the following statements.
1. Gross national income - indirect taxes + undivided profits - transfers
  2. Gross national income + Transfers - income tax - exports
  3. Gross national income - indirect taxes + transfers - undivided profits
  4. Gross national income - transfers + indirect taxes + capital depreciation (capital consumption)
  5. Gross national income - income not received by household - income taxes - transfers (.....)
26. The value of the gross domestic product to the current market price in Sri Lanka at present (2016) is approximately,
- |                     |                     |
|---------------------|---------------------|
| 1. 50 billions USD  | 2. 100 billions USD |
| 3. 980 billions USD | 4. 75 billions USD  |
| 5. 81 billions USD  | (.....)             |
27. Marginal propensity to consume is 0.8 in a simple economy when the autonomous investment is increased by Rs. 200 millions, the expansion of the equilibrium income is,
- |                      |                      |                     |
|----------------------|----------------------|---------------------|
| 1. Rs. 1600 millions | 2. Rs. 1000 millions | 3. Rs. 400 millions |
| 4. Rs. 200 millions  | 5. Rs. 160 millions  | (.....)             |
28. In a certain hypothetical economy when the consumption function changes from  $C = 350 + 0.6 y_d$  to  $C = 425 + 0.75 y_d$  the change that occurs in the national income is,
- |                     |                     |                      |
|---------------------|---------------------|----------------------|
| 1. Rs. 88 millions  | 2. Rs. 875 millions | 3. Rs. 1700 millions |
| 4. Rs. 825 millions | 5. Rs. 75 millions  | (.....)              |

29. From which of the following statements is the macro economic equilibrium most accurately defined,
1. It is a point that the production is maximized
  2. It is a condition on which forces that create a change in the income and output level do not operate
  3. It is a condition on which savings and investments are equal
  4. It is a condition of full - employment of services.
  5. It is a condition which does not have an inflationary effect. (.....)

30. In a certain hypothetical economy the aggregate expenditure curve changes as follows.



Mention the reasons in an order that affect for the aggregate expenditure curve in he above hypothetical economy to change from E to E<sub>1</sub> and from E to E<sub>2</sub>

1. increase in the average propensity to consume and increase in the investment.
  2. decrease in the marginal propensity to save and increase in the government expenditure.
  3. increase in the marginal propensity to save and increase in the autonomous taxes.
  4. decrease in the marginal propensity to save and increase in the autonomous taxes.
  5. increases in the marginal propensity to save and increase in the government expenditure. (.....)
31. when the price level rises.
1. holders of financial assets with fixed money values increase their spending.
  2. the demand for money and interest rate rise.
  3. spending which is sensitive to the interest rate changes increases.
  4. holders of financial assets with fixed money values have more purchasing power
  5. demand for money and the interest rate decline. (.....)
32. Which of the following group would not be hurt by unanticipated inflation?
1. fixed nominal income earners.
  2. Low income earners.
  3. Those who have money savings.
  4. Those who become debtors when prices were lower
  5. Those who predict future investments. (.....)
33. A supply side factor that affects for the price inflation is,
- |                                    |                                       |
|------------------------------------|---------------------------------------|
| 1. increase in government spending | 2. increase in investment expenditure |
| 3. increase in net exports         | 4. increase in the price of inputs    |
| 5. increase in money supply.       | (.....)                               |

34. Which of the following is not related to the cost push theory of inflation?
1. An increase in government expenditure
  2. Imposing tax by the government
  3. Excessive wage gains
  4. Supply - shocks
  5. All the above factors (.....)
35. Suppose that the nominal value of the gross domestic product of the country has declined within a certain time period. The variable that can be assumed to be declined within that time period, in that country is,
1. deficit of the trade balance
  2. real output
  3. budgetary deficit
  4. aggregate demand
  5. inflation rate (.....)
36. Assume that the banking system of a closed economy is consisted of a single commercial bank. The reserve rate is 40%. If an amount of Rs. 8000 is newly deposited what is the maximum amount of loans that can be issued from the bank?
1. Rs. 4200
  2. Rs. 4800
  3. Rs. 12000
  4. Rs. 20000
  5. Rs. 3200 (.....)
37. Identify the impact of purchasing government securities in the open market by the Central Bank of Sri Lanka.
1. the reserves in the banks would decrease and the money supply would decrease.
  2. Reserves in banks would fall and the money supply in the country would rise.
  3. Reserves in banks would increase and the base money would decrease.
  4. Reserves in banks would increase and the base money would also increase.
  5. Reserves in banks would decrease and the base money would decrease. (.....)
38. What would be the impact that is created when the Central Bank provides the commercial banks with the standard deposit facilities on the policy interest rate is,
1. The interest rate of the inter - bank call money market falls and the upper and lower limits of the interest rate corridor are determined.
  2. interest rate does not change in the inter - bank call money market.
  3. interest rate in the inter bank call money market rises and the lower limit of the interest rate corridor is determined.
  4. interest rate in the inter bank call money market falls and the lower limit of the interest rate corridor is determined.
  5. interest rate in the inter bank call money market falls and the upper limit of the interest rate corridor is determined. (.....)
39. Which is considered from the following as the asset with the least liquidity?
1. treasury bonds
  2. demand deposits
  3. time deposits
  4. inter - bank call money
  5. fixed deposit (.....)
40. At present when operating the financial policies by the Sri Lanka Central bank which is from following considered as the basic objective?
1. establishing the economic stability.
  2. creating a sustainable development.
  3. Increasing the tax revenue.
  4. Contraction of the money supply
  5. Maintaining the inflation rate in a mid single digit in the medium term. (.....)



41. The market equilibrium output of a good produced by a foreign investment company had exceeded the social optimum level. If an excess production is created, through that production,
1. favorable effect has made on the society.
  2. unfavorable effect has made on the society.
  3. returns of the consumption has created.
  4. Cost of the consumption has created.
  5. a favorable product has been produced to the society. (.....)

42. The highest contribution to the government by the tax revenue in Sri Lanka in 2016 was made by,
1. tax on value added
  2. production taxes
  3. import taxes
  4. expenses tax
  5. income taxes (.....)

43. A government charges taxes to fulfil various aims, what is from the following not an aim of charging taxes?
1. provision of public goods and welfare goods.
  2. creating an equity
  3. Reducing problems relating to the balance of payment
  4. uplifting the economic growth
  5. increasing the government revenue. (.....)

44. The balance of the current account and the total balance as a percentage of the gross domestic Production in 2016 approximately is,

	<b>Total balance</b>	<b>Current Account balance</b>
1.	- 6.2	- 1.1
2.	- 5.6	- 0.9
3.	- 6.4	- 1.2
4.	- 7.6	- 2.3
5.	- 5.4	- 0.6 (.....)

45. The government debt has taken a very high value as a percentage of the gross domestic product in recent years. How much is it?

1. 79.3%	2. 82.3 %	3. 102.2 %	4. 92.1 %	5. 90.3%	(.....)
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46. Assume that the output produced within an hour by a labourer in Japan and France is as follows.

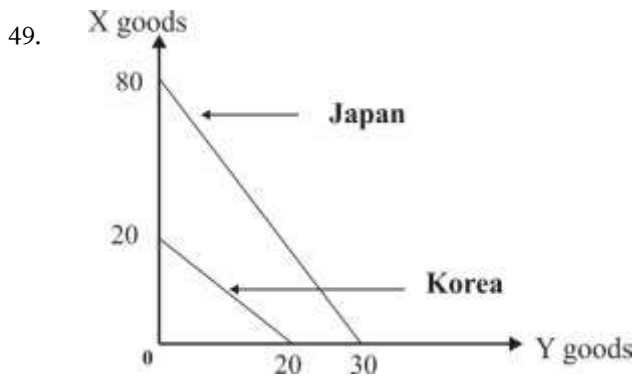
	<b>Exercise</b>	
	<b>Books</b>	<b>Pens</b>
Japan	8	4
France	8	2

According to this data the most accurate statement from the following regarding the free trade between Japan and France,

1. Japan exports exercise books and France exports pens.
2. Japan exports pens and France exports exercise books.
3. Japan exports both exercise books and pens.
4. France imports exercise books and exports pens.
5. Both Japan and France produce both goods and are exported. (.....)

47. Which is from the following not a disadvantage of foreign trade?
1. discouragement on domestic infant industry.
  2. creating disadvantages through dumping.
  3. increase in dependency on the foreign trade.
  4. Dependency on the foreign investment.
  5. Rise in the level of domestic welfare. (.....)

48. What is meant by the concept of 'dumping' in the international trade?
1. polluting the international seas out of the legal sea boundary in the countries.
  2. achieving comparative advantages regarding the removal of garbage's.
  3. exporting goods at a lower price than the average production cost.
  4. exporting low quality goods to developing countries by the developed countries.
  5. destroying the excess production. (.....)



The above diagram illustrates two hypothetical production possibilities curves for the two countries, Japan and Korea. It is assumed that there will be no trade barriers,

1. Japan has a comparative advantage of both good X and Y
  2. Korea has an absolute advantage of both goods, X and Y
  3. No any country can gain an advantage by the trade
  4. Both countries can earn advantages by the trade
  5. Japan will export Y goods to Korea. (.....)
50. By December since January 2016 the value of an American dollar changed from Rs. 150 to Rs. 155. This change depicts,
1. depreciation of the rupee value
  2. increase in the rupee value
  3. revaluation of rupee value
  4. depreciation of the dollar value
  5. devaluation of the American dollar (.....)



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21 E II

**Second Term Test - Grade 13 - 2018**

Index No : ..... **Economics II** **Three Hours**

**Important**  
♦ **Select at least two questions from each section and answer for five questions.**

**Part - A**

- 01. i. " As the rain is scarce in the drought season, rain water is an economic good." Do you agree to this statement? Give reasons for your answer ( 4 marks)
- ii. To which productive resource do the followings belong?
  - a. hydro - electricity power station
  - b. making the patients of medical clinic aware
  - c. a stock of halfly made ready-made clothes
  - d. wild elephants (4 marks )
- iii. Although every point on the production possibility frontier illustrates the productive efficiency why is the economic efficiency limited to only one specific point on the production possibility frontier? Explain your answer through a diagram. (4 marks)
- iv. What are the differences between the labour and entrepreneurship as a productive factor? (4 marks)
- v. Explain how the major functions are solved through the price mechanism in a market economy? ( 4 marks)
- 02. i. What are the conditions that should be fulfilled to satisfy a want? (2 marks)
- ii. 'Quantity demanded is a negative function of price of a good when other things held to be constant' Mention three factors that are mentioned here is assumed to be constant (3 marks)
- iii. consider that elasticity of the market supply curve relevant to the agricultural good is inelastic. If the government decides to provide a specific production subsidy on this good, explain how the benefit of the subsidy is shared using a diagram. ( 4 marks)
- iv. The equilibrium price for a certain good is Rs. 60/- and the equilibrium quantity is 400 units. When the price of the good is Rs. 50/= the excess demand is 200 units and 300 units are supplied.
  - a. Illustrate the market demand and supply functions for this good through formula. (4 marks)
  - b. If the government decides to impose a specific tax of Rs.10 /= on one unit of good calculate the new equilibrium price and price received by the producer. (4 marks)
  - c. If government activates the price supporting policy of purchasing the excess by certifying a minimum price at Rs. 70 /= per unit instead of a unit tax, what is the government expenditure on this? (3 marks)

03. i. (a) Explain the production Function (2 marks)  
 (b) Distinguish between short term and long term of the production process? (2 marks)
- ii. Explain the difference between normal profit and super normal profit. (4 marks)
- iii. Illustrate through a diagram of earning zero economic profit or normal profit by a production firm in the short term. (4 marks)
- iv. Introduce increasing returns to scale and name the factors that affect for creating the increasing returns to scale (4 marks)
- v. Compare perfect Competition and monopolistic competition based on any four features (4 marks)

04. i. Briefly introduce private consumption expenditure, investment expenditure, government purchases and net exports (6 marks)
- ii. According to the methodology of the Sri Lanka Central Bank annual report show the total resources and their utilization according to the market price. (4 marks)
- iii. Following is macro economic data relevant to a certain hypothetical economic system. (values in billions)

Private consumption	650
government purchases	170
gross domestic fixed capital formation	180
Stock changes	300
exports	200
imports	300
net foreign factor income ( Primary income)	500
Net foreign private transfers	150

Calculate the followings.

- A. Gross domestic expenditure  
 B. Gross domestic production to the market price  
 C. Gross national income to the market price  
 D. Domestic savings  
 E. national savings

05. i. Name other factors that influence for the determination of the consumption expenditure except to the disposable income.
- ii. a. Illustrate through a diagram how the equilibrium income is determined in the simple economy.  
 b. Name the withdrawal and injections in an open economy and explain why they are concerned as withdrawals and injection.
- iii. The Savings function of a closed economy with government affairs, is  $S = -175 + 0.25 yd$ . Investments of this economy is Rs. 100 millions, Government purchases and autonomous tax are respectively as Rs. 110 million and Rs. 100 million.
- a. Calculate the equilibrium output level of this economy (2 marks)  
 b. Calculate the tax multiplier and the government expenditure multiplier (2 marks)
- iv. Explain through diagrams the concepts of inflationary gap and the unemployment gap (2 marks)
- v. In a closed economy without a government the MPC is 0.6 As the investment expenditure is increased by Rs. 200 million, explain how the income is increased within the first four rounds in the economy. (4 marks)

## Part - B

06. i. Define inflation and explain the measures that can be taken by the government to control the inflation (3 marks)
- ii. What is a price index? Mention two differences between the national consumers' price index and the Colombo consumers' price index used in Sri Lanka. (5 marks)
- iii. How do the creeping inflation and galloping inflation affect for the function of the financial system in the economy? (4 marks)
- iv. Distinguish between the demand - pull inflation and the cost - push inflation. (4 marks)
- v. Show the relationship between the stock of money and the general price level associating the equation of exchange (4 marks)
07. i. " No any income is earned if money is kept on hand as money." If so why do people keep money with them? (3 marks)
- ii. What are the limitations of creating money in Commercial Banks? (3 marks)
- iii. Following is a simple balance sheet of creating money in a Commercial Bank (3 marks)

Liabilities	Assets
Demand deposits 400	Reserves 80
	Lending <u>320</u>
<u>400</u>	<u>400</u>

Consider that 480 million of public currencies and 40 million of excess reserves are available in the banking system

- a. What is the value of deposit multiplier? (2 marks)
- b. When the credit creation is completed what is the money supply of the banking system? (2 marks)
- c. When the reserve rate is 25% and credit creation is completed what is the money supply of the banking system? (2 marks)
- iv. What are the measures that are taken by the government to absorb excess liquidity in commercial banks? (2 marks)
- v. Explain methods that are taken by the central bank to reduce the money supply (6 marks)
08. i. Explain why the government intervention in a market economy can be justified? (4 marks)
- ii. Explain through a diagram, how the market system becomes a failure when there are positive externalities in consumption. (4 marks)
- iii. What are the types of non - tax revenue? (4 marks)
- iv. Explain the composition of recurrent expenditure of the government in 2016 (4 marks)
- v. Distinguish between the primary balance and the net financial deficit in the government debt (4 marks)

09. i. What is meant by fiscal consolidation? (2 marks)
- ii. What are the targets of revenue based fiscal consolidation? (3 marks)
- iii. What are the factors that caused for the imbalance in the public finance in Sri Lanka in 2016 ? (3 marks)
- iv. Distinguish between the comparative advantage and the absolute advantage of the foreign trade (6 marks)
- v. Name the non - tax security measures that can be followed to get rid of disadvantages that have to be faced by the undeveloped countries by joining the foreign trade affairs. (6 marks)
10. i. Mention the sources of the international trade (4 marks)
- ii. What are the advantages that can be gained by a certain country by joining the foreign trade (4 marks)
- iii. Followings are the quantities of output per unit of resource relating to the computers and motor vehicles produced by United States of America and the United Kingdom.
- |                 | U.S.A | U.K |
|-----------------|-------|-----|
| Computers       | 2     | 10  |
| Mortar vehicles | 5     | 6   |
- a) Name the country that earns absolute advantage and give reasons.
- b) Show the country that earns comparative advantages with reasons relating to the two goods. (6 marks)
- iv. What are the assumptions based on the theory of comparative advantage. (4 marks)

**Second Term Test**  
**Economics – 13 - 2018 - Answer Sheet**

**Paper- I**

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1) 4	11) 3	21) 1	31) 2	41) 2
2) 2	12) 2	22) 4	32) 4	42) 4
3) 3	13) 5	23) 1	33) 4	43) 5
4) 2	14) 3	24) 2	34) 1	44) 5
5) 1	15) 4	25) 5	35) 4	45) 1
6) 4	16) 4	26) 5	36) 3	46) 2
7) 5	17) 5	27) 2	37) 4	47) 5
8) 2	18) 1	28) 4	38) 3	48) 3
9) 4	19) 3	29) 2	39) 1	49) 4
10) 1	20) 3	30) 3	40) 4	50) <u>1</u>

**Paper- II**

- i.** do not agree
- Economic goods are the goods that are produced utilizing the economic resources in the production. An Opportunity cost is Created in the production. (1 marks)
  - Economic good are scarce in supply. But merely Scarcity in supply does not help to identify economic goods. (1 marks)
  - Although scarcity in supply can be noticed as there is no production cost or and oppoportuning cost raing water is a non - economic good. (2 marks)
- ii.**
- a. hydro electricity power station - capital
  - b. awareness progtramme to patients in a medical climic - Labour
  - c. a stock of halfly made ready made - Capital
  - d. Wild elephants - land
- iii.**
- Productive efficiency means producing the optimum product mox with the least cost. For that the conditions of full exmployment of services and full production should be fulfilled. Then the economy can work on the curve. Thus, every point on the PPC depicts the productive efficiency.
  - To achieve economic efficiency allocatie effificeay along with the productive efficieny should be achieved. Then the resources in the economy can be efficiently utilize to satisfy the wants of citizens. There, the price of the good or the marginal cost should be equal to the marginal benefits. That specific point indicates the relevant product mix.
- iv.**
- Entrepreneurship organizes the production activities combining the other productive factors.
  - Labour is tue physical and mental effort used in the production activity.
  - The earaing of the entrepreneurship is profit or loss. The earning of the labour is wage.
  - The income as entrepreneur may be positive, negative or zero
  - But the earning of labour takes a positive value.
  - Enterpreneaship functions bearing risks. But labour doesn't want to face a risk as it has been employed. ( 1 marks for comparative differences, Total 4 for four comparative differences)
- v.**
- The major functions of the market economy is to solve the basic economic problems what, how and to whom is to produce. For this purpose, the price mechanism is used.
  - What and what amount to be produced.
  - Scarce resources are allocated on the production of more profitable goods and services based on the price signals given by factor and commodity markets.

**How is it produced?**

The most efficient production methad with the least cost is choen considering the prices of factors and the available technology.

**To Whom is to produce.**

The production is distributed among those who have the purchasing power as the personal income is defermind on the amount of factors supplied and the factor prices.

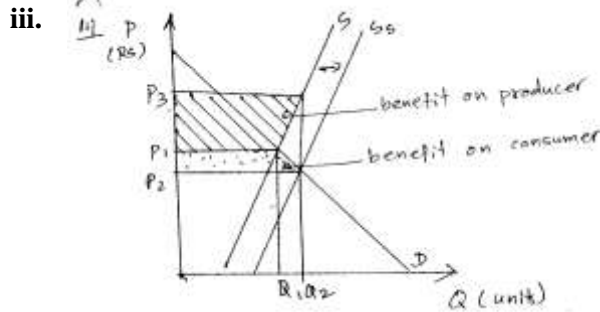
( 1 marks for one factor total - 4 marks)

02).

- i. - Willingness to consume a good or a service
- affordability / purchasing power
- plan to purchase
- ii. - Price of related goods
- consumers' income
- future expectation of price

(If all the three factors are available 2 marks)

(1 mark for 01 factor total marks 3)



(2 marks for the accurate diagram)

iv. (e) Demand function

(a)  $b = \frac{100}{-10} = -10$   
 $400 = a - 10 \times 60$   
 $= a - 600$   
 $1000 = a$   
 $Q_d = 1000 - 10p$  (2 marks)

Supply function  $b = \frac{100}{10} = 10$   
 $Q_s = a + 10p$   
 $400 = a + 10 \times 60$   
 $400 = a + 600$   
 $400 - 600 = a$   
 $-200 = a$   
 $Q_s = -200 + 10p$  (2 marks)

b. Supply function after the tax

$$Q_{st} = -200 + 10(p - 10)$$

$$= -200 + 10P - 100$$

$$= -300 + 10p$$

At the equilibrium as  $Q_d = Q_{st}$   $Q_{st}$ ,

$$1000 - 10P = -300 + 10P$$

$$1300 = 20P$$

$$\frac{1300}{20} = P$$

$$65 = P$$

The new equilibrium price after the tax

Rs. 65

(2 marks)

Price received by the producer after the tax.

65 - 10 Rs. 55

(2 marks)

C. Quantity demanded at the price of Rs. 70 / =

$$Q_d = 1000 - 10 \times 70$$

$$= 1000 - 700$$

$$= 300$$

Quantity supplied at the price of Rs. 70 / =

$$Q_d = 200 - 10 \times 70$$

$$= 200 + 700$$

$$= 500$$

$$Q_s = 500 - 300$$

$$= 200$$

(1 marks)



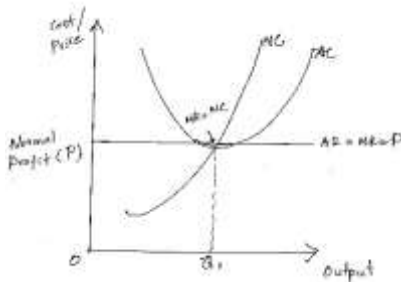
The govt expenditure on purchasing the excess =  $200 \times 70$

= Rs. 14000

(2 marks)

(Answer through chagrams can be given marks)

- i. a. The technical relationship between the inputs and outputs in the production process in the production illustrated as,
  - It can be illustrated as,  $Q = f(L,K)$  (2 marks)
- b.
  - The short term is the production in which at least one factor cannot be changed.
  - There fore, in the short term two types of factors such as fixed inputs and variable inputs can be seen. (2 marks)
- ii.
  - Normal profit is the minimum payment expected by the entrepreneur to be exist in the production process. (1 marks)
  - Normal profit is a derived cost as it is a payment made on the functions of the enterpreneurur.
  - If he is not earned at least that. minimum payment he exists from the business. (1 marks)
  - Super Normal profit is the surpls earning earned exceeding the ippotunity coast of all the resources used in the production process. (1 marks)
- iii. When economic profit is zero total revenue is equal to the total cost. And also, when the price of a unit (AC) , [ P - AC] At that point, the firm earns normal profits.



Accrding to the above diagram when  $MR = MC$ ,  $P = AC$

Under this situation the firm earns normal profits. (2 marks for the diagram explanation 2 marks)

- iv. - Returns to scale is the real return that is earned by increasing the efficiency of productive vesources as a result of broadening the capacity of the firm in the long run.
  - In the long rum increase in the output in a graterpercentage than the percentage of changing all the inputs is the increasing returns to scale.
  - eg: When inputs are increased by 50 % the output increased by 80% (2 marks)
  - Facors that affect the increasing refurus to scale.
    - indivisibility of factors / division of labour and specialization.
    - ability to use machinery
    - availability of expenses that should bear once.

( 2 marks for 2 resons)

v.

Feature	Perfectly competitive	Monopotistic capy
1. Number of firms	Very large number	large
2. the manner of goods produced	homogene eg - paddy / earrot	diffientiated products eg. canteens, barber saloons.
3. enty	free entry & exit	free
4. price determenation	- price taker - firms operates according to a certified price $P = Mc$ - demand curve is perfectly elastic	Price maker $P > Mc$
5. demand curve	- demand curve is perfectly elastic	- a demand curve that slopes downward from left to right

( If characteristics are compared 4 marks)

- i. - Private consumption expenditure means spending made by house hold purchasing consumers' goods and services.
- Investment expenditure means expenditure made on achieving capital assets such as machinery, factories, houses etc. By adjusting stock changes to that gross domestic capital formation ( gross investment) is calculated.
- Govet purchases means expenditure made by the government to purchase goods and services It includes both govt consumption expenditure and investment expenditure.
- Net export is the differences between exports of goods and services and imports. (6 marks)

ii. Resources.

- Gross domestic product
- Imports of goods and services. (2 mark)

Utilization of resources.

- Consumption
- gross domestic fixed capital formation.
- Stock changes.
- exports of goods and services. (2 marks)

iii. a. Gross domestic expenditure = C + I + G  
 = 650 + (180 + 300) + 170  
 = 1300 (2 marks)

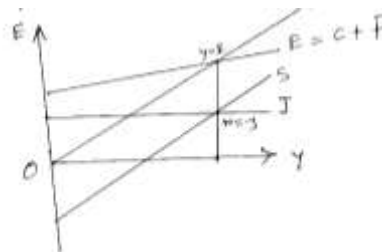
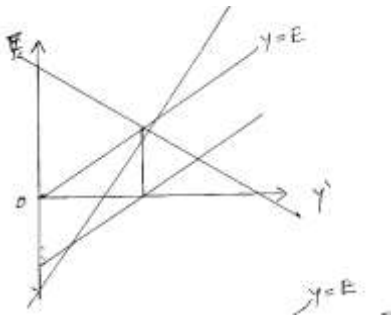
b. G.D.P. to the market price = C + I + G + X - M  
 G.D. expenditure + net exports  
 1300 + (-100) = 1200 (2 marks)

c. G.N.P to the market price G.D.P. to the marked price + net foreign factor income  
 1200 + 500 = 1700 (2 marks)

d. Domestic savings = Gross domestic capital formation + net exprots.  
 180 + 300 + (-100) = 380 (2 marks)

e. Natinal savings = Domestic savings + net foreign factor income + net foreingn private transters  
 380 + (-100) + 150 = 430 (2 marks)

05. i. - wealth owned by household ( Stock of assets)  
 - expectations of household.  
 - loans received by household.  
 - price level / anticipated inflation. (2 marks for any 2 reasons)



- b. withdrawals of an open savings, taxes and imports (S) (T) (M)  
 Injections - investimet, govt. purchases, (J) (G)  
 (01)



- ii. Price indices are used to measure the changes in price level between two time periods. The change in price of the relevant time period relatively to another time period is measured as a percentage through price indices. ( 1 marks)

Special features	National consumers' price index	colombor consumers' price index
1. base year	2013 - 100	2006 / 07 = 100
2. Geographical features	All the provinces in Sri Lanka	An the urban areas in Colombo district
3. tatgetted household units	All the household units in every province	All the household units of the urban area in the Colombo district
4. Number of household units	3.9	4.4
5. Average Monthly Consumption expenditure	Rs. 32, 142.69	Rs. 27, 972.11
6. Manjor groups sub groups	12 105	10 95
7. Total of items	407	373
percentage of total weight	44. 04	41.03
i. food	55.96	58.97
ii. Non - food iteams		
Price collecting centres	03 price collecting centeres for every unit and for every district	14 price collecting centers as to cover Colombo urban areas.

( 2 marks for any 2 differences marsk 4)

- iii. Continuous increase in the general price level of goods and services for a long time in a steady rate is the creeping inflation.

When the annual average inflation rate decreases to 5 % it is considerd that a creeping inflation exists.

Galloping inflation is the increasing the general price level in a hight rate. That occurs when the prices of goods and services increase at two - digit or three - digit rate per annu.

**Alernative answer.**

( When prices of goods and services rice at a double, triple digit rate per annum, that situation is know as galloping inflation. It is a serious problem for an economy and causes various economic distortion and disturbances.)

During a creeping inflation the rate of increasing price cand be predicted. As well as the prices are in a fixed level the value of money does nto decrease rate of increasing price are in a fixed level the value of money does not decrease rapidly. Thus, the financial system operates properly well. ( 1 marks)

But , Durng a gollaping inflation as the price of goods and services increases in a vate of two or three digits the purchasing power of money declines rapidly. Thus, people show less interes to keep mony with them. On behalf people tend to accumulate goods and real assets it obstructs the proper - function of the financial system. ( 1 marks)

( Total marks 04)

- iv. Demand pull - inflation is ass to arise when aggregate demand in and economy outpaces aggregate supply. It involves inflation vising as real gross domestic product rises and unemployment falls. Theis is commonly described as ' too much money chasing too few goods'.

Increase in Autonomous consumption, autonomous investment, government expenditure, and autonomous exports as well, decrease in autonomous imports, autonomous taxes etc. Cause for the rise in aggregate demand. ( 2 marks)

Cost push inflation is the inflation caused by an increase in general prie level as a result of increase in production cost. This is caused by increase in imported raw materials, increase in wages as a result of unidns, increases in bank interest rates and decrease in the foing exchange rate. (2 marks)

( Total marks 04)

v. Quantity theorists mention that there is a positive relationship between the stock of money and the general price level. That means a change in the stock of money will create a proportional change in the price level. ( 2 marks)

Quantity theory of money shows the relationship between the stock of money and the price level through the Equation of exchange,  $MC = PT$  ( $MC = PY$ )

Based on the assumptions relating to the behavior of the variables included in the equation, the Equation of exchange can be turned to a theory.

The two assumptions used as follows,

- i. the velocity of money to be constant
- ii. the real volume (Y) of the economy to be constant OR the economy operates on the level of full employment of services.

If the variable 'V' and 'Y' are constant a proportional relationship is created between M and P ( 2 marks)  
( Total Marks 4)

- 07). i - transaction motive  
 - Precautionary motive  
 - Speculative motive ( 3 marks)

- ii. - financial policies of the central bank  
 - Excess reserves of the commercial banks  
 - demand for loans  
 - willingness of the public to keep money with them  
 ( 3 marks for 03 facts)

**iii. Reserve rate**

$$\frac{40}{400} \times 100 = 10\%$$

$$K = \frac{1}{R} = \frac{1}{10/100} = 1 \times \frac{100}{10} = \underline{10} \quad ( 2 \text{ marks})$$

b.  $M_1 = \text{Public currencies} + \text{bank money}$   
 $= 480 + 80 \times 10$   
 $= 480 + 800$   
 $= \underline{1280} \quad ( 2 \text{ marks})$

c.  $M_1 = \text{public currencies} + \text{bank money}$   
 $= 480 + 80 \times 4$   
 $= 480 + 320$   
 $= \underline{800} \quad ( 2 \text{ marks})$

- iv. - daily open market operations  
 - introduction of standard deposit facility rate  
 - holding auctions for time repurchases ( 2 marks for two reasons)

- v. - Increasing reserve requirements.  
 - Selling treasury bills  
 - increasing interest rates.

**- increasing reserve requirements.**

when the central bank increases the reserve rate excess reserves of the central bank declines. Then the ability of issuing loans will be decreased. Credit creation will be lower. Then the total money supply of the country will decrease.

**- Selling treasury bills**

When the central bank sells treasury bills in the open market commercial banks purchase them. Then, the excess reserves of the commercial banks decline. It declines the ability of credit creation in the commercial banks that leads to the decline of the money supply in the country.

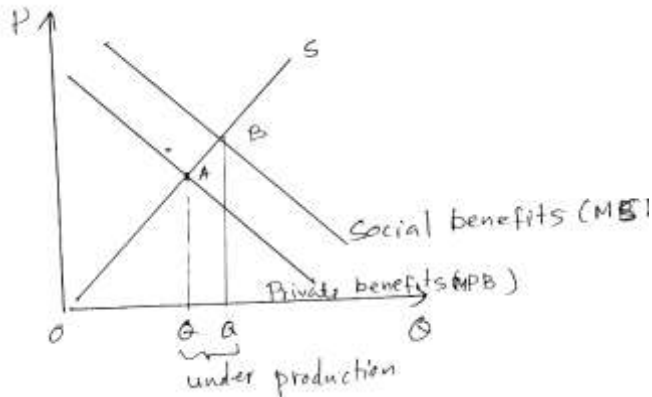
- **Increasing the interest rate.**

When the central bank increases the money supply commercial banks also increase the interest rates for their loans. Then, the opportunity cost of borrowing loans increases and decreases the ability to taking loans. That results the decline in the money supply in the country.

08). i. the government intervention in the market economy can be justified due to the availability of various weaknesses and inefficiencies in the market economy.

- eg.
- non - provision of public goods under provision of welfare goods.
  - not consider about the externalities
  - absence of equity
  - macro economic imbalances
  - non - provision of infrastructure facilities
  - existence of under production and excess production. (3 marks for 3 facts)

ii.



When there are positive externalities in the consumption social optimum consumption exceeds the market optimum consumption. It creates an under production in the country. Thus, it creates market failures.

( For explanation 2 marks)

- iii. - profit and dividends  
 - interest income  
 - fees and charges  
 - property income  
 - sales income  
 - fines  
 - public enterprise gross earning

(4 marks for 4 facts)

iv.

	percentage on the G.D.P	percentage on the current expenditure
- expenses on goods and services	6.3%	42%
- government loan interests	5.2%	35%
- Current expenses	3.4%	23%

(naming 2 marks)

When considering the current expenditure of the Sri Lankan government in 2016 about 42% is on goods and services and the transfer expenditure is about 58% salary payments of the government servants included in the current expenditure has taken a high value. (for the explanation 2 marks)

- v. - The primary deficit of the government budget is the negative value that is received when deduction the government loan interest out of the overall budgetary deficit. The overall balance that is calculated without the loan interest is the primary balance. If it takes a negative value. It is known as the primary deficit. (2 marks)
- The net financial deficit of the government budget is the negative value that is received by deducting the loan instalments out of the overall budgetary deficit. (2 marks)

- 09). i. Public finance integrity is the policies that are operated with the aim of minimizing the accumulation of loans and minimizing the government budgetary deficit. (2 marks)
- ii. - Expanding the tax base.  
 - improveing the tax administration  
 - minimzing tax negligence and evation  
 - changing the tax rates  
 - logicization of tax allowance ( 3 marks for three facts)
- iii. - Existence of the publice income at a low level as a percentage of the gross domestic product.  
 - Sri Lanka 14.2 %  
 - Asia 26.6 %  
 - Minus government savings - 0.6 %  
 - Degeneration of the tax base  
 - weak tax collection
- ( 3 marks for 3 facts)**
- iv. - Comparative advantage is a situation when a country produces a good - or service for a lower opportunity cost utilizing and equal amout of resources, than other countries and exports to foreing countries. (3 marks)  
 - Absolute advantage is the ability of an economy to produce a grater quantity of a good, product or service with the least cost (higher efficiency) than competitors, using the same amount of resoures. ( 3 marks)  
 - Comparative advantage is considered with the least cost where as the absolute advantage is considered with the least cost.
- v. - Quoto system - exchange central  
 - import licence. - operating of trade agreements  
 - imposing standard of production. - exstablishing cartesls (6 marks for 6 facts)
- 10). i. - tehnological differences and innovations  
 - Change in the stock of resoureces  
 - Presence of economies of scale in the production.  
 - change in the preference.  
 - Specialization  
 - Opening condition  
 - location of countries  
 - government policies  
 - market structure ( 4 marks for 4 facts.)
- ii. - broadening of the market  
 - ability to export the excess production produced within the country.  
 - ability to import the goods that cannot be produced within the country.  
 - ability of exchange technological knowledge.  
 - ability of importing goods with a high production cost if produced domestically, at a low cos from a foreingn country.  
 - paving the way for a lagrge scale of production  
 - ability to achieve the returns of specialization and exchange.  
 - increasing the domestic welfare level ( 4 marks for 04 facts)
- iii a. The absolute advantage of both production is gained by the united kingdown. The reason is the ability of the united kingdom of produncing both goods with a greater efficiency than the U.S.A. (2 marks)
- b. United states of America**
- |                                     |   |                                 |                  |
|-------------------------------------|---|---------------------------------|------------------|
| Opportunity cost of a computer      | = | $\frac{5}{2} = \underline{2.5}$ |                  |
| Opportunity cost of a motor vehicle | = | $\frac{2}{5} = \underline{0.4}$ | <b>(1 marks)</b> |

**United kingdom**

Opportunity cost of a computer =  $\frac{6}{10} = \underline{0.6}$

Opportunity cost of a motor vehicle =  $\frac{10}{6} = \underline{1.6}$

- the united kingdom has the comparative advantage of producing computers with a lower opportunity cost than U.S.A. (2 marks)
- the U.S.A has the comparative advantage of producing motor vehicles as they can produce motor vehicles with a lower opportunity cost than the U.K (2 marks)

**iv. -Assumptions**

- Considering only two countries and two goods.
- Availability of only the labour resource.
- the resource accumulation of both countries are equal.
- non - availability of mobility in labour between two countries.
- existence of fixed returns to scale in both countries.
- absence of cost on transportation. (4 marks for 04 facts)