

Economics I

Two hours

Instructions :

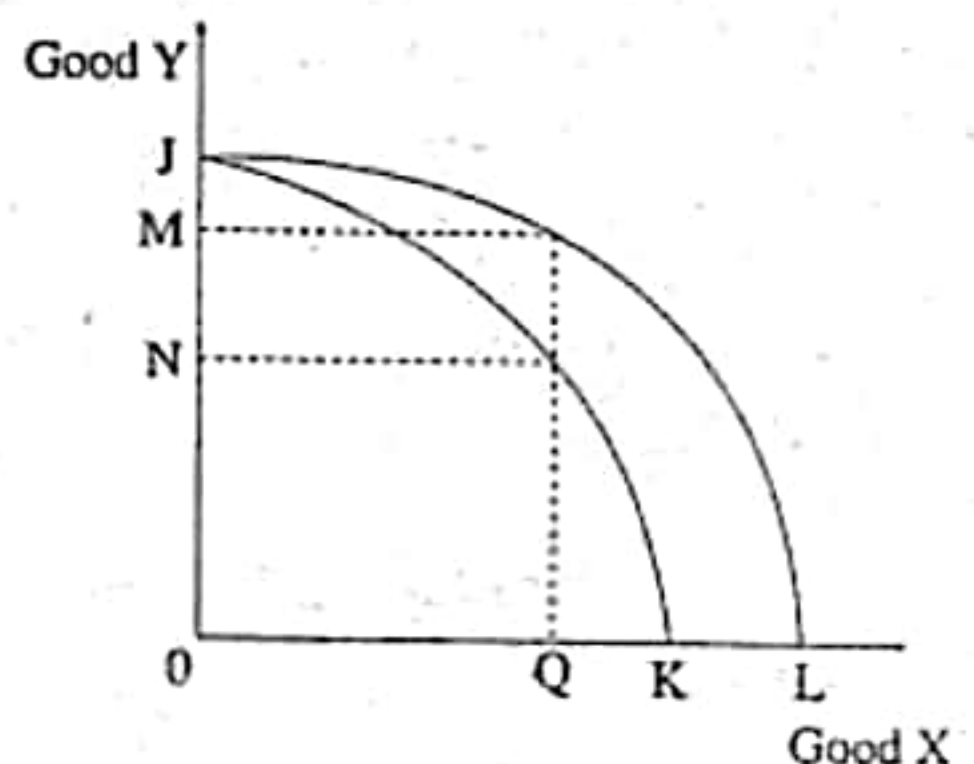
- ❖ Answer all the questions.
- ❖ Write your Index Number in the space provided in the answer sheet.
- ❖ Instructions are given on the back of the answer sheet. Follow those carefully.
- ❖ In each of the questions 1 to 50, pick one of the alternatives from (1), (2), (3), (4), (5) which is correct or most appropriate and mark your response on the answer sheet with a cross (X) in accordance with the instructions given in the back of the answer sheet.

1. A point inside a production possibility frontier
 - (1) indicates some unemployed resources.
 - (2) is unattainable.
 - (3) is better than points on the production possibility frontier.
 - (4) indicates fully employed resources.
 - (5) illustrates the idea of opportunity cost.
2. The branch of economics that studies the decisions of individual households and firms is called
 - (1) macroeconomics.
 - (2) microeconomics.
 - (3) positive economics.
 - (4) normative economics.
 - (5) home economics.
3. Which one of the following is a normative statement?
 - (1) Economists classify economic resources as land, labour, capital and entrepreneurship.
 - (2) The environment is an example of a scarce resource.
 - (3) If income increases sales of luxury goods will fall.
 - (4) Economies have limited resources to satisfy unlimited wants.
 - (5) An unequal distribution of resources is unfair.
4. Which one of the following is an example of a natural resource?
 - (1) Victoria dam
 - (2) Hambantota harbour
 - (3) A paddy field
 - (4) A poultry farm
 - (5) Dunhinda waterfall
5. An economic good is one which
 - (1) has an opportunity cost in production.
 - (2) does not use up resources.
 - (3) is supplied competitively.
 - (4) makes a profit.
 - (5) is available even at a zero price.

6. The diagram shows production possibility curves before and after a technological advancement affecting the production of good X.

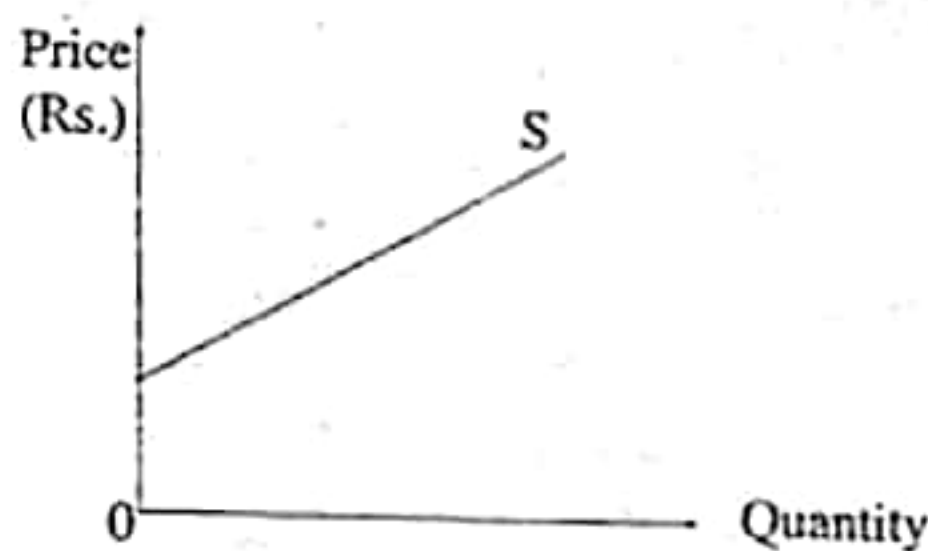
Which one of the following distances represents the reduction in the opportunity cost of producing OQ of good X in terms of good Y?

- (1) JO
- (2) JN
- (3) MN
- (4) KL
- (5) QK



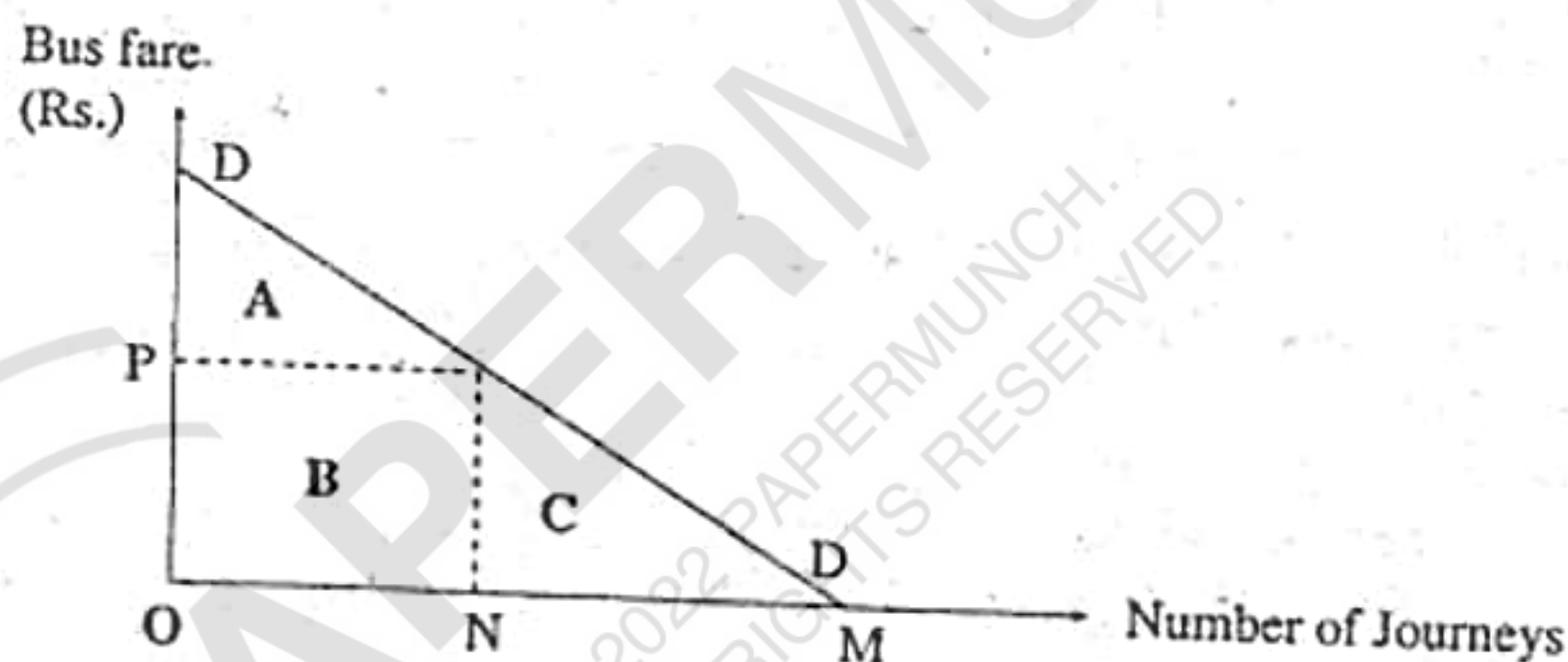
7. An economic system characterized by private ownership of the factors of production, market allocation of resources and decentralized decision making is called.
- (1) market economy. (2) traditional economy.
 (3) social market economy. (4) command economy.
 (5) centrally planned economy.
8. When the price mechanism is used to allocate resources, market prices
- (1) must rise.
 (2) are usually regulated by the central government.
 (3) are solely determined by the production costs.
 (4) do not respond to the changes in demand.
 (5) signal to producers the strength of demand and supply.
9. One of the main functions of prices in a market economy is to
- (1) allocate scarce resources.
 (2) provide a mechanism for firms to make profits.
 (3) improve economic stability.
 (4) improve the distribution of income.
 (5) determine the elasticity of demand curves.
10. A shift of the demand curve for a product to the right could be caused by a
- (1) fall in the price of a close substitute.
 (2) fall in the price of the good itself.
 (3) rise in income.
 (4) rise in the price of a complementary good.
 (5) rise in the cost of production.
11. Which of the following is not held constant when a demand curve is drawn?
- (1) Consumers' money income (2) Consumers' tastes
 (3) The price of the good itself (4) The prices of substitutes
 (5) The prices of complementary goods
12. The demand for a particular 'normal good' is inversely related to price while its supply is positively related to price. During a given time period, 5000 units are sold at a price of Rs. 50 a unit and during a latter period 8000 units are sold at a price of Rs. 60 per unit. Which one of the following could account for this change?
- (1) An increase in the price of a complement.
 (2) An increase in the price of a substitute.
 (3) Imposition of a sales tax on the good.
 (4) An increase in the productivity of inputs.
 (5) An increase in the cost of raw materials.
13. The price elasticity of demand for a product manufactured by a firm is - 0.8. If the firm raises the price of the product, its revenue will
- (1) rise. (2) fall.
 (3) stay the same. (4) fall by more than 8%.
 (5) fall by less than 8%.

14.



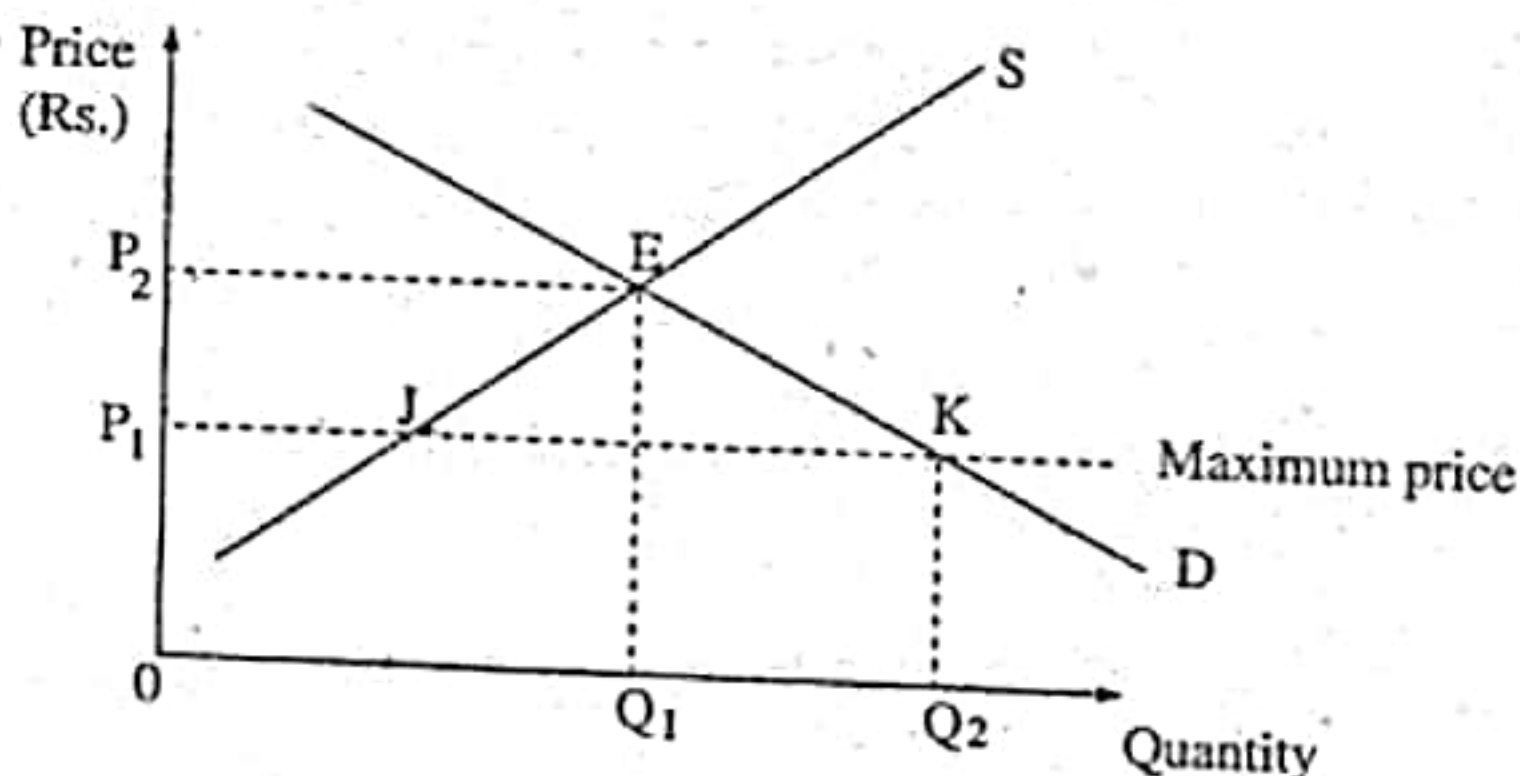
Which statement correctly describes the price elasticity of supply along the curve shown in the above diagram?

- (1) It is constant and greater than unity at all quantities.
 - (2) It is constant and less than unity at all quantities.
 - (3) It is equal to unity at all quantities.
 - (4) It diminishes as quantity increases.
 - (5) It increases as quantity increases.
15. A market is defined as being in equilibrium when
- (1) there is maximum output at minimum cost.
 - (2) the producer surplus is maximized.
 - (3) prices are at their lowest possible level.
 - (4) consumer satisfaction is maximized.
 - (5) there is no tendency for the market price to change.
16. Assuming the price elasticity of demand for a product is zero, any tax imposed on the product will
- (1) leave the position of the supply curve unchanged.
 - (2) shift the supply curve to the right.
 - (3) shift the demand curve to the right.
 - (4) be paid entirely by the producer.
 - (5) raise the price of the product by the full amount of the tax.
17. In the diagram below, DD represents the demand for bus service in a university community.



The bus fare per journey was OP and the number of journeys per day was ON. If the university authorities decide to provide the bus service free of charge and as a result the number of journeys increases to OM, how will consumers surplus change?

- (1) From A to A + C
 - (2) From A to B + C
 - (3) From A to A + B + C
 - (4) From B to A
 - (5) From A + B to A + B + C
18. The diagram below shows the supply of, and demand for, rice with market equilibrium at E. Assume that government decides to impose a maximum price of P_1 per unit of rice.



The most likely outcome of maximum pricing policy would be

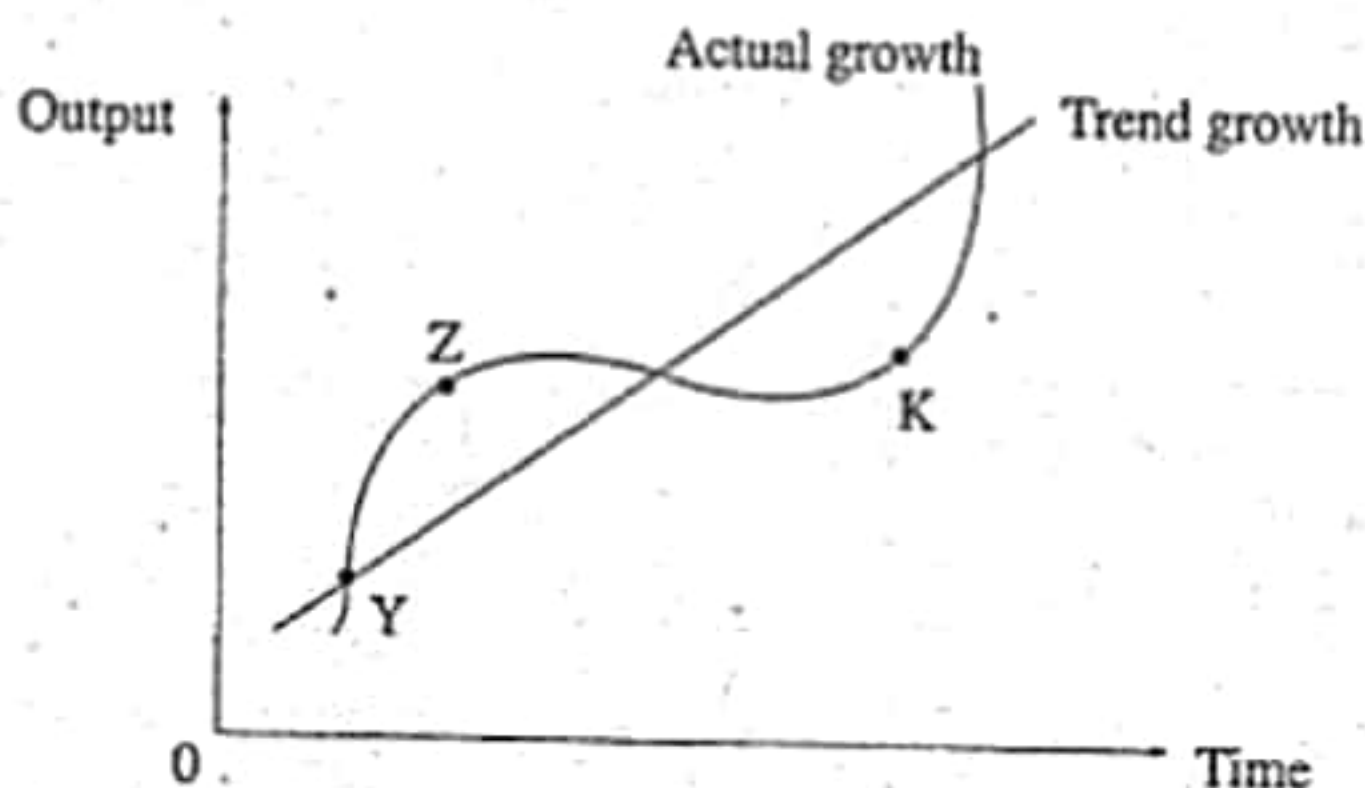
- (1) an excess supply of rice by JK.
 - (2) a shortage of rice by OQ_2 .
 - (3) the rising of equilibrium price of rice above OP_2 .
 - (4) a reduction in price from OP_1 .
 - (5) an excess demand for rice by JK.
19. Which of the following statements best describes the operation of the Law of Diminishing Returns?
- (1) As the consumption of a good increases, total satisfaction rises but at a diminishing rate.
 - (2) As more of a variable factor is added to a fixed factor, total product rises but at a diminishing rate.
 - (3) As all factors are increased in proportion, total product rises but at a diminishing rate.
 - (4) As more of a variable factor is added to a fixed factor, the marginal cost of production diminishes.
 - (5) As all factors are increased in proportion, the marginal cost of production increases.
20. The short run marginal cost of producing good X is indicated by the schedule below.

Unit of X	1	2	3	4	5	6	7
Marginal cost (Rs.)	30	20	16	24	40	56	64

Given that total fixed cost is Rs. 30, at what level of output is short run average total cost (ATC) lowest?

- (1) 2 units (2) 3 units (4) 4 units (5) 5 units (6) 6 units
21. Which one of the following is **not** consistent with perfect competition?
- (1) A large number of producers and consumers
 - (2) Advertising by individual firms
 - (3) One market price only
 - (4) A homogeneous product
 - (5) A perfectly elastic demand curve for each firm
22. For a firm in equilibrium in perfect competition, average revenue is,
- (1) less than marginal revenue and both are positive.
 - (2) equal to marginal revenue and both are zero.
 - (3) equal to marginal revenue and both are positive.
 - (4) greater than marginal revenue which is zero.
 - (5) greater than marginal revenue which is positive.
23. Mango cultivators sell their harvest to a factory manufacturing mango jam for Rs. 5000. The factory sells jam to a supermarket for Rs. 8000. This supermarket sells mango jam to consumers for Rs. 10 000. What is the correct statement of this production process?
- (1) The value added by the supermarket is Rs. 10 000.
 - (2) The value added by the manufacturing firm is Rs. 8000.
 - (3) The total value added in the production activity is Rs. 23 000.
 - (4) The value added by the supermarket is Rs. 3000.
 - (5) The total value added is Rs. 10 000.

24. The diagram shows trend and actual growth path for an economy.



Which one of the following combinations describes the state of the economy when it moves from point Y to point Z on its actual growth path?

	Stage of the Business Cycle	Output Gap
(1)	Boom (Expansion)	Negative
(2)	Recession (Contraction)	Positive
(3)	Boom (Expansion)	Positive
(4)	Recession (Contraction)	Negative
(5)	Trough	Positive

25. Which of the following changes must be made to convert Gross Domestic Product at market prices to Net National Product at factor cost?

	Depreciation	Net Factor Incomes From Abroad	Indirect Taxes	Subsidies
(1)	add	add	deduct	add
(2)	add	deduct	deduct	add
(3)	add	deduct	add	deduct
(4)	deduct	add	deduct	add
(5)	deduct	add	add	deduct

26. The consumption function of an economy is given by the equation, $C = 600 + 0.8Y$ where $C =$ consumption and $Y =$ national income. What is the correct conclusion that can be drawn from this information?

- (1) Savings are positive at all levels of income.
 (2) Marginal propensity to save declines as income increases.
 (3) Marginal propensity to consume declines as income increases.
 (4) The average propensity to consume is constant.
 (5) The average propensity to consume declines as income increases.
27. In a closed economy with no government, the value of the investment multiplier is 5. By how much will consumption increase, if investment increases by Rs. 200 million?
- (1) Rs. 200 million (2) Rs. 400 million (3) Rs. 600 million
 (4) Rs. 800 million (5) Rs. 1000 million
28. Other things remaining constant, which one of the following would cause aggregate demand to increase? An increase in
- (1) taxation on income. (2) interest rates.
 (3) savings. (4) government expenditure.
 (5) imports.

29. 'The multiplier' usually refers to how an initial increase in investment, government spending, or exports leads to a large increase in the level of
- (1) prices. (2) interest rate. (3) unemployment.
 (4) savings. (5) income.

30.

Item	Amount (Rs. billion)
Household consumption	70
Government purchases	20
Net taxes (=taxes-transfers)	25
Investment	15
Imports	5
Exports	10

According to the information given in the table, the value of household savings in this economy is

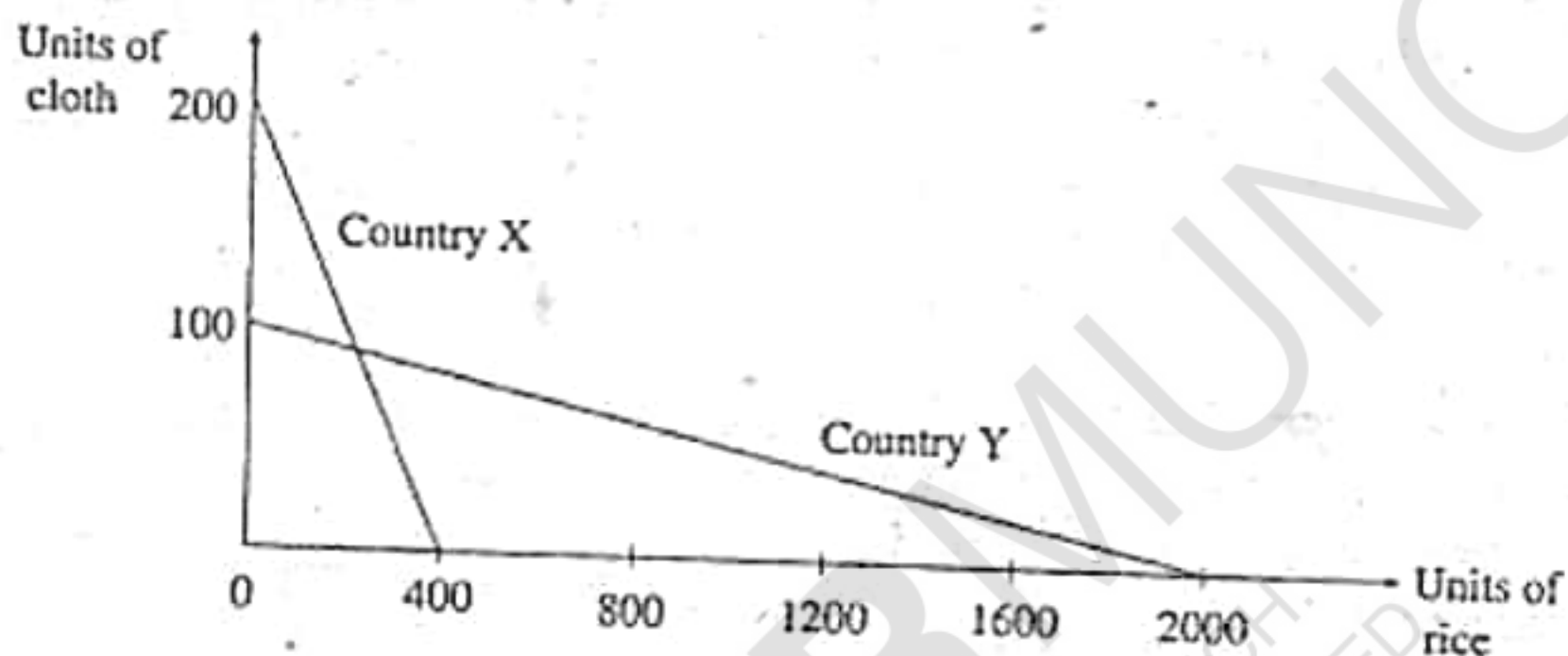
- (1) -40 billion rupees. (2) -15 billion rupees. (3) 15 billion rupees.
 (4) 40 billion rupees. (5) 45 billion rupees.
31. The following table shows the balance sheet of a commercial bank in a banking system.

Liabilities (million rupees)		Assets (million rupees)	
Deposits	2000	Reserves	500
		Loans	1500
Total	2000	Total	2000

If the statutory reserve requirement is 15%, this commercial bank has excess reserves of

- (1) Rs. 200 million. (2) Rs. 300 million. (3) Rs. 500 million.
 (4) Rs. 1500 million. (5) Rs. 1700 million.
32. Which of the following is a liability of a commercial bank?
- (1) Time and saving deposits (2) Cash on hand
 (3) Deposits on Central Bank (4) Commercial bills discounted
 (5) Bank overdraft facilities
33. When the Central Bank of Sri Lanka enters into a reverse repo agreements with commercial banks.
- (1) interest rates in the call money market will move upwards.
 (2) interest rates in the call money market will move downwards.
 (3) Money supply will be contracted.
 (4) the deposits held by the commercial banks with the Central Bank will be reduced.
 (5) interest rates in the call money market will not be affected.
34. Disinflation is
- (1) a decline in the general price level.
 (2) negative inflation.
 (3) a decline in prices of essential goods.
 (4) a decrease in the rate of inflation.
 (5) the deliberate reduction of the value of one currency in terms of another.
35. Which one of the following is a source of market failure?
- (1) An increase in firm's profit resulting from excess demand for its product.
 (2) Government intervention to correct a divergence between private and social benefits.
 (3) Inequalities in the distribution of income and wealth.
 (4) Increasing diseconomies of scale as a firm increases production.
 (5) Existence of competition in the market.

36. Merit goods are likely to be under-provided in a free-market economy because their
- (1) private benefits exceed their social benefits.
 - (2) social benefits exceed their social costs.
 - (3) private costs exceed their private benefits.
 - (4) social benefits exceed their private benefits.
 - (5) social costs exceed their private costs.
37. When applied to a public good, 'non-rival in consumption' means that
- (1) there is a single monopoly supplier of the good.
 - (2) the consumption of the good by one person does not reduce the amount of the good available to others.
 - (3) the people who do not pay cannot be excluded from the consumption.
 - (4) if the good is provided for one person it must be provided for others.
 - (5) the resources used in its production could not be used to produce other goods.
38. The diagram shows the amounts of rice and clothing that can be produced in countries X and Y with a given quantity of resources.



- What does the diagram indicate about the production of these two commodities?
- (1) Country X has both an absolute and a comparative advantage in clothing.
 - (2) Country X has a comparative advantage in rice and an absolute advantage in clothing.
 - (3) Country X has a comparative advantage in clothing and an absolute advantage in rice.
 - (4) Country Y has a comparative advantage in rice and an absolute advantage in clothing.
 - (5) Country Y has both an absolute and comparative advantage in clothing.
39. The multilateral financial institute which has offered highest volume of foreign grants to Sri Lanka in recent years is
- (1) Asian Development Bank.
 - (2) International Bank for Reconstruction and Development.
 - (3) International Development Association.
 - (4) EXIM Bank of China.
 - (5) OPEC Fund for International Development.
40. Consider the following table.

Year	Export Price Index	Terms of Trade Index
1	100	100
2	90	80
3	80	60

From the table one possible conclusion that can be drawn over the period shown is

- (1) export prices were rising.
- (2) import prices were rising.
- (3) both export and import prices were falling.
- (4) there was an improvement in the terms of trade.
- (5) more imports could be purchased with the same quantity of exports.

48. Three main deprivations reflected in the multi-dimensional poverty index are
- (1) health, education and standard of living.
 - (2) income, nutrition and longevity.
 - (3) sanitation, child mortality and nutrition.
 - (4) literacy, drinking water and years of schooling.
 - (5) health, income and assets.
49. According to 'Mahinda Chinthana-Development Policy Framework', Sri Lanka is expected to double its per capita income in 2016. What is the expected level of investment to achieve this target?
- | | |
|----------------------------|----------------------------|
| (1) 8 - 10 percent of GDP | (2) 24 - 28 percent of GDP |
| (3) 33 - 35 percent of GDP | (4) 38 - 40 percent of GDP |
| (5) 40 percent of GDP | |
50. The national official poverty line in Sri Lanka is based on
- (1) the per capita food expenditure per month.
 - (2) earnings of US dollar 1.25 per day.
 - (3) average per capita calorie requirement per day.
 - (4) average non-food expenditure of households per month.
 - (5) the real per capita food and non food consumption expenditure per month.

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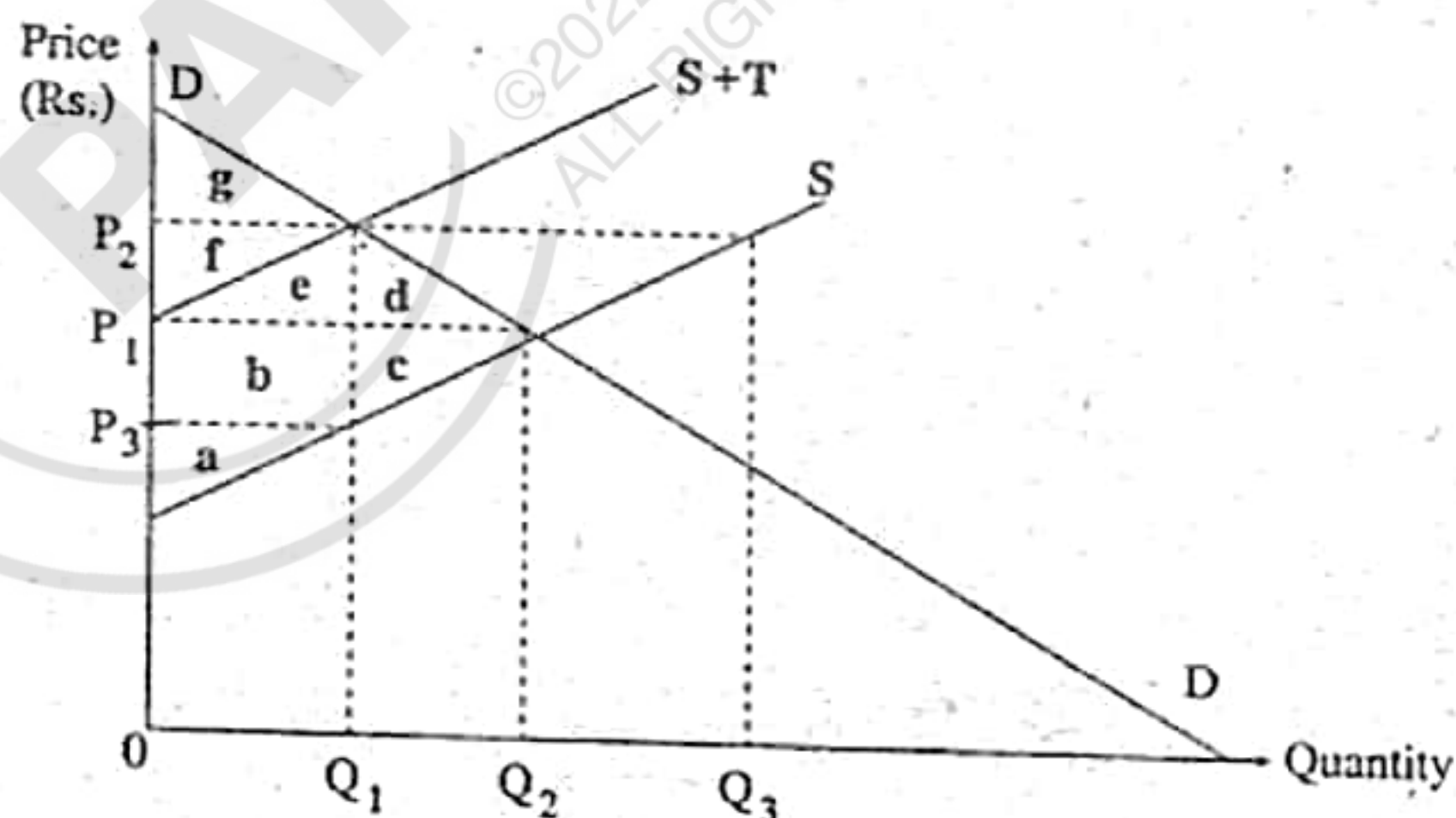
Economics II - Three hours**Instructions :**

- ❖ Answer five questions only, selecting minimum of two questions from sub-section A and two questions from Sub-section B.
- ❖ Graph papers will be provided.

Sub Section A

(Select minimum of two questions from this section.)

1. (i) What are the **three** basic economic questions any economic system must address? (03 marks)
- (ii) How different types of economic systems answer the question what goods and services will be produced? (04 marks)
- (iii) What are the **three** functions of price in a market economy? (03 marks)
- (iv) What is meant by the 'Law of Increasing Opportunity Cost'? How do you explain the reasons for this Law? (06 marks)
- (v) Distinguish between a 'bad', a 'good', an 'economic good' and a 'free good'. (04 marks)
2. (i) List the main factors that determine the consumer demand for a good. (04 marks)
- (ii) Distinguish between a 'normal good', 'inferior good' and a 'Giffen good'. (03 marks)
- (iii) "The price of personal computers has continued to fall even in the face of increasing demand." Explain the situation using an appropriate diagram. (05 marks)
- (iv) In this diagram, DD represents demand curve, S and S + T represent respectively supply curve before and after specific production tax imposed by the government.



- (a) At the equilibrium price before the tax is imposed, what area represents consumer surplus? What area represents producer surplus? (02 marks)
- (b) After the tax is imposed on the producers, what area represents the consumer surplus? (02 marks)

- (c) What area represents the dead-weight loss of the tax? (02 marks)
- (d) What area represents the revenue raised by the government? (02 marks)
3. (i) Distinguish between the short run and the long run in production. (02 marks)
- (ii) Explain the 'Law of Diminishing Returns'. (02 marks)
- (iii) Explain the difference between explicit and implicit costs giving examples. (04 marks)
- (iv) What are economies of scale? How do they arise? (06 marks)
- (v) What are the **four** types of market structures? Explain the distinguishing characteristics of any **one** of them. (06 marks)
4. (i) What categories of incomes are included in the income approach of calculating GDP? (05 marks)
- (ii) How does the problem of double counting arise in calculating GDP, and how is it corrected? Explain your answer with an example. (05 marks)
- (iii) The following is information from the national income accounts of a hypothetical open economy. Assume that all taxes are direct taxes and there are no subsidies.

Item	Value in million rupees
GDP (at current prices)	6000
Gross investment	800
Net investment	200
Private consumption	4000
Government purchases	1100
Government budget surplus	30

Calculate the following :

- (a) Net Domestic Product (b) Net exports
- (c) Net taxes (taxes minus transfers) (d) Disposable personal income
- (e) Personal savings (05 marks)

(iv) Explain the usefulness of compiling national income statistics for a country. (05 marks)

5. (i) What are the components of aggregate expenditure in an open economy? Define each component. (06 marks)
- (ii) What is the relationship between the savings function and the consumption function? (02 marks)
- (iii) For a closed economy with no government, suppose the consumption function is given by $C = 100 + 0.8Y$, while investment is given by $I = 50$.
- (a) What is the equilibrium level of income of this economy? (02 marks)
- (b) What is the level of savings in equilibrium? (02 marks)
- (c) If, for some reason, income is at the level of 800, what will the level of involuntary inventory accumulation be? (02 marks)
- (d) If investment (I) rises to 100, what will the effect be on the equilibrium income? (02 marks)
- (e) Draw a diagram indicating the equilibria in both (a) and (d). (04 marks)

Sub Section B

(Select minimum of two questions from this section.)

6. (i) What is meant by a 'double coincidence of wants'? (03 marks)
- (ii) Explain why credit cards are not money. (03 marks)
- (iii) What are the **three** principal conditions required for the banking system to create money? (03 marks)
- (iv) Suppose that the Central Bank purchases a bond for Rs. 100 000 from a brokerage firm which deposits the proceeds in one of the commercial banks in the banking system.
- (a) What will be the impact of this transaction on the supply of money? (02 marks)
- (b) If the reserve requirement ratio is 20%, what is the maximum amount of additional loans that this commercial bank will be able to extend as a result of this deposit? (02 marks)
- (c) Given the 20% reserve requirement, what is the maximum increase in the amount of deposits that could result throughout the entire banking system because of the Central Bank's action? (02 marks)
- (d) Would you expect this to happen? Explain your answer. (02 marks)
- (v) Identify **three** lending programmes implemented by the Central Bank of Sri Lanka in order to promote regional development and poverty alleviation. (03 marks)
7. (i) What are the main economic functions of government? (04 marks)
- (ii) What is meant by a 'pure public good'? (02 marks)
- (iii) Give one example each for the following externalities:
- (a) Negative externalities in production
- (b) Positive externalities in production
- (c) Negative externalities in consumption
- (d) Positive externalities in consumption (04 marks)
- (iv) What are the major sources of tax revenue in Sri Lanka at present? (05 marks)
- (v) "Over 17% of current expenditure of the government comprises of transfers to households." Identify **five** major items coming under this expenditure category. (05 marks)
8. (i) List **four** main items each of exports and imports of Sri Lanka. (04 marks)
- (ii) List **five** arguments often to support trade restrictions. (05 marks)
- (iii) Distinguish between 'nominal rate of protection' and 'effective rate of protection'. (05 marks)
- (iv) Distinguish between flexible, fixed and managed exchange rates. (06 marks)
9. (i) What is 'inclusive economic growth'? (04 marks)
- (ii) Are 'economic growth' and 'sustainable development' incompatible? Discuss. (04 marks)
- (iii) In what ways can the government policies influence to raise the growth rate of economies? (04 marks)

- (iv) Is Human Development Index a better indicator of economic development than the level of per capita income? Explain. (04 marks)
- (v) Examine the recent trends of the Human Development Index for Sri Lanka. (04 marks)
10. (i) "The Mahinda Chinthana: Vision for the Future aims at doubling the current per capita income by 2016." What are the challenges facing Sri Lanka in achieving this goal? (04 marks)
- (ii) What is the current status of foreign direct investment (FDI) in Sri Lanka? (04 marks)
- (iii) What are the factors hindering the rapid growth of foreign direct investment (FDI) inflows to Sri Lanka? (04 marks)
- (iv) Examine the salient features of the 'Gama Neguma' programme as a strategy to achieve balanced regional development in the country. (04 marks)
- (v) Examine the recent trends in national and sectoral poverty levels in Sri Lanka. (04 marks)

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