

**පැරණි නිර්දේශ/பழைய பாடத்திட்டம் / Old Syllabus**

ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව  
 இலங்கைப் பரீட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம்  
 Department of Examinations, Sri Lanka  
 இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரīட்சைத் திணைக்களம் இலங்கைப் பரīட்சைத் திணைக்களம் இலங்கைப் பரīட்சைத் திணைக்களம்

**OLD**

**අධ්‍යයන පොදු සහතික පත්‍ර (උසස් පෙළ) විභාගය, 2019 අගෝස්තු**  
**கல்விப் பொதுத் தராதரப் பத்திர (உயர் தர)ப் பரீட்சை, 2019 ஆகஸ்ட்**  
**General Certificate of Education (Adv. Level) Examination, August 2019**

ආර්ථික විද්‍යාව **I**  
 பொருளியல் **I**  
**Economics I**

**21 E I**

**05.08.2019 / 1300 - 1500**

පැය දෙකයි  
 இரண்டு மணித்தியாலம்  
**Two hours**

Page No.	Question No.	Marks
01	01 - 04	
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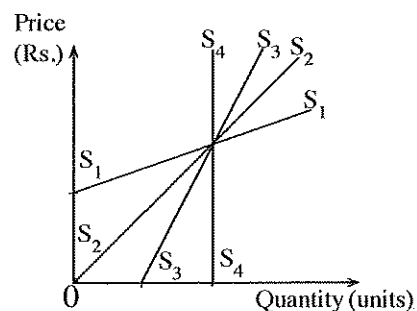
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**Instructions:**  
 \* Answer all the questions on this question paper itself.  
 \* Write your **Index Number** in the space provided above.  
 \* Select the correct answers for questions 1-50 and write its number on the dotted line given.

- The central problem of economics is
  - to establish a democratic political framework for the provision of public goods and services.
  - the establishment of prices that accurately reflect the relative scarcities of goods and resources.
  - the scarcity of productive resources relative to human wants.
  - to achieve a more equitable distribution of money income in order to mitigate poverty.
  - to achieve sustainable development. (.....)
- Human Capital is
  - all capital owned by individuals, but not by corporations and government.
  - all capital owned by individuals and corporations, but not by government.
  - machinery that meets safety standards for use by humans.
  - the skills and knowledge endowment of workforce.
  - construction of infrastructure for schools and hospitals. (.....)
- Productive efficiency implies
  - the use of the least-cost techniques of production.
  - the production of the product-mix most wanted by society.
  - the full employment of all available resources.
  - production at some point inside of the production possibilities curve.
  - a technological improvement substituting labour with capital. (.....)
- As productive resources are scarce, it needs to give up some of one good in order to acquire more of another. This is the essence of the concept of
  - specialization. (2) implicit cost.
  - comparative advantage. (4) absolute advantage.
  - opportunity cost. (.....)

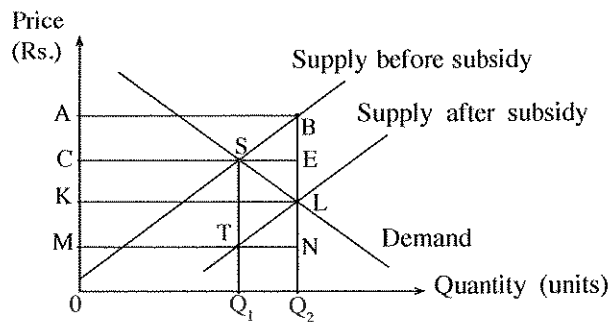
5. By which of the following can economic growth be depicted using a production possibilities frontier?  
 (1) A rightward shift of the curve  
 (2) A movement upward on an existing curve  
 (3) A movement downward on an existing curve  
 (4) A movement from a point outside the curve to a point on the curve  
 (5) A movement from a point on the curve to a point inside the curve (.....)
6. The idea that consumers determine what is produced in the economy through their demands is known as  
 (1) a laissez-faire economy. (2) a market economy. (3) consumer sovereignty.  
 (4) free enterprise. (5) a mixed economy. (.....)
7. Which of the following is true of the substitution effect of a decrease in the price of a normal good?  
 (1) It works to offset the income effect.  
 (2) It works to reinforce the income effect.  
 (3) It is less than the income effect.  
 (4) It causes a decrease in the quantity demanded of the good.  
 (5) It causes an increase in the demand for the good. (.....)
8. Which of the following would shift the supply curve of a good to the right?  
 (1) An increase in the cost of production  
 (2) A decrease in the cost of production  
 (3) An increase in the price  
 (4) A decrease in the price  
 (5) A decrease in demand (.....)
9. Which of the following indicates that two goods are substitutes?  
 (1) A positive income elasticity of demand  
 (2) A cross-price elasticity of demand is less than zero  
 (3) A price elasticity of demand is less than one  
 (4) A positive cross-price elasticity of demand  
 (5) A horizontal demand curve (.....)
10. If the government imposes a tax on the production of air conditioners, which of the following will occur in the market for air conditioners?  
 (1) There will be a movement to the right along the supply curve.  
 (2) There will be a movement to the right along the demand curve.  
 (3) The supply curve will shift to the right.  
 (4) The supply curve will shift to the left.  
 (5) The demand curve will shift to the right. (.....)
11. If the total revenue of a firm increases by 10% as a result of an increase in price by 20%, the demand it faces in this price range must be  
 (1) inelastic. (2) elastic. (3) unitary elastic. (4) perfectly elastic. (5) perfectly inelastic. (.....)

12. The diagram below shows four market supply curves. Which statement is correct about the price elasticity of supply curves?



- (1) Curve  $S_1S_1$  has decreasing elasticity as price rises.  
 (2) Curve  $S_2S_2$  has increasing elasticity as price rises.  
 (3) Curve  $S_3S_3$  has decreasing elasticity as price rises.  
 (4) Curve  $S_4S_4$  has constant infinite elasticity.  
 (5) Curve  $S_2S_2$  has elasticity greater than one. (.....)

13. The diagram below shows the market for an essential consumer product before and after the introduction of a subsidy on production.



What is the total amount of money paid in subsidies?

- (1) OKLQ<sub>2</sub>      (2) OCSQ<sub>1</sub>      (3) OABQ<sub>2</sub>      (4) ABEC      (5) KABL      (.....)

14. Assume that good X is sold in a competitive market. Which of the following is true if a unit tax is imposed on the production of good X?

- (1) If the demand curve is perfectly elastic, the price does not rise by the amount of the tax.  
 (2) If the demand curve is perfectly inelastic, the price does not rise by the amount of the tax.  
 (3) The consumer's burden of the tax rises, as the demand curve is more elastic.  
 (4) The consumer's burden of the tax rises, as the demand curve is less elastic.  
 (5) Consumers surplus rises as a result of the tax.      (.....)

15. Diminishing marginal returns occurs when the

- (1) marginal product of an input is rising.  
 (2) marginal product of an input is zero.  
 (3) marginal product of an input is falling.  
 (4) total product of an input is zero.  
 (5) total product of an input is negative.      (.....)

16. Which of the following is an implicit cost for the owner of a small restaurant?

- (1) The wage paid to the assistant manager  
 (2) The cost of purchasing meat from a wholesale supplier  
 (3) The cost of water supplied by the Water Supply Board  
 (4) The value placed on the owner's skills in an alternative career  
 (5) The cost of property taxes paid to the local administrative authority      (.....)

17. Which of the following is true of the perfectly competitive firm in the short run?

- (1) The firm always earns a normal profit.  
 (2) The firm shuts down if the price falls below average total cost.  
 (3) The firm always earns positive economic profit.  
 (4) The firm maximizes profit by producing where the price equals marginal revenue.  
 (5) The firm may earn positive profit or negative profit or normal profit.      (.....)

18. Which of the following is a characteristic of a perfectly competitive market structure?

- (1) Firms produce a homogeneous product.  
 (2) Barriers to entry exist.  
 (3) Firms are price-setting profit maximizers.  
 (4) Always earn normal profits in the short run.  
 (5) The government regulates the price to eliminate dead weight loss.      (.....)

19. Consider a firm is operating in a perfectly competitive market. What will be the effect on the firm's total revenue if it increases its output by 5%?

- (1) Total revenue will be unchanged.  
 (2) Total revenue will increase by 5%.  
 (3) Total revenue will increase by less than 5%.  
 (4) Total revenue will increase by more than 5%.  
 (5) Total revenue will become zero.      (.....)

20. In the circular flow model of an economy with no government sector and no international trade, households

- (1) receive income from buyers of final products.
- (2) receive income from the sale of resources in the goods market.
- (3) pay business firms for the use of their resources.
- (4) receive income from producers for the use of their factors of production.
- (5) pay income to producers for the use of their savings.

(.....)

21. The Table below presents nominal data on the components of Gross Domestic Product based on expenditure approach for a hypothetical economy. (All figures are in Rs. billion)

Year	C	I	G	X	M
2017	600	200	100	250	150
2018	650	300	150	300	250

Assume that the index for the GDP deflator of this economy increased from 100 in 2017 to 110 in 2018. What is the growth rate of real GDP in 2018?

- (1) 5%.
- (2) 10%.
- (3) 12%.
- (4) 15%.
- (5) 16%.

(.....)

22. The value of intermediate goods is **not** included in the calculation of GDP

- (1) because they are consumed in the current year.
- (2) because of the tremendous difficulty in keeping track of all intermediate goods produced in the economy.
- (3) because they are only sold in goods markets.
- (4) to keep from including goods that reduce society's welfare.
- (5) to avoid counting their value twice and thereby overstating the value of GDP.

(.....)

23. If the government increased spending by Rs.600 billion and increased taxes by Rs. 600 billion to cover the increased spending then which of the following combinations would correctly explain the effect on the budget and GDP?

	Budget	GDP
(1)	Unchanged	Decrease
(2)	Surplus	Decrease
(3)	Unchanged	Unchanged
(4)	Surplus	Increase
(5)	Unchanged	Increase

(.....)

24. The data presented in the following Table describes the relationship between Disposable Gross National Income and aggregate consumption expenditure of an economy.

Disposable Gross National Income (Rs. billion)	Aggregate Consumption Expenditure (Rs. billion)
800	700
860	745
920	790
980	835

What can be deduced about the value of marginal propensity to consume in this economy?

- (1) It increases with the increase of disposable gross national income.
- (2) It decreases with the increase of disposable gross national income.
- (3) The value of the marginal propensity to consume is 0.87.
- (4) The value of the marginal propensity to consume is 0.45.
- (5) The value of the marginal propensity to consume is 0.75.

(.....)

25. Assume an economy currently operating at an equilibrium level of output at Rs.5 000 billion with a marginal propensity to consume of 0.8. If the full employment equilibrium of this economy is Rs.7 000 billion, which of the following policy measures would ensure achievement of full employment?
- (1) Decrease taxes by Rs.2 000 billion
  - (2) Increase government spending by Rs.2 000 billion
  - (3) Increase government spending by Rs.500 billion
  - (4) Decrease taxes by Rs.500 billion
  - (5) Decrease taxes by Rs.400 billion (.....)

26. Assume that in a closed economy without a government sector, the aggregate saving function is  $S = -100 + 0.2Y$  and the equilibrium level of national income is Rs.2 000 billion. What is the level of investment for this economy?
- (1) Rs.100 billion
  - (2) Rs.200 billion
  - (3) Rs.300 billion
  - (4) Rs.400 billion
  - (5) Rs.500 billion (.....)

27. The Table below shows some macroeconomic data for a hypothetical Economy. (All figures are in Rs. billion).

Government Purchases (G)	Imports (M)	Taxes (T)	Investment (I)	Exports (X)	Saving (S)
30	70	40	50	80	60

Which of the following statements about this economy is correct?

- (1) Economy expands because exports are greater than imports.
  - (2) Economy contracts because savings are greater than taxes.
  - (3) Economy expands because injections are greater than withdrawals.
  - (4) Economy contracts because withdrawals are greater than injections.
  - (5) Economy is in equilibrium because injections are equal to withdrawals. (.....)
28. Cost-push inflation might start with
- (1) a rise in money wage rate.
  - (2) an increase in government purchases.
  - (3) an increase in the quantity of money.
  - (4) an increase in money income.
  - (5) a reduction in tax rates. (.....)
29. In a hypothetical economy, if the nominal Gross Domestic Product is Rs.8 trillion and the money Supply is Rs.2 trillion, the velocity of money is
- (1) 0.25.
  - (2) 2.
  - (3) 4.
  - (4) 6.
  - (5) 8. (.....)
30. The money multiplier is the ratio of
- (1) bank deposits to bank reserves.
  - (2) bank deposits to high-powered money.
  - (3) bank deposits to excess reserves.
  - (4) money supply to high-powered money.
  - (5) the currency to bank reserves. (.....)
31. The Central Bank can increase the money supply by
- (1) selling their gold reserves to the commercial banks.
  - (2) selling their foreign currency holdings.
  - (3) buying government bonds in the open market.
  - (4) buying gold from foreign Central Banks.
  - (5) borrowing reserves from foreign governments. (.....)

32. Open market operations refer to

- (1) buying and selling of stocks in the Colombo Stock Market.
- (2) loans made by the Central Bank to commercial banks.
- (3) buying and selling of government securities by the Central Bank.
- (4) government purchase of foreign bonds.
- (5) granting subsidies by the government to promote exports. (.....)

33. Assume that the statutory reserve requirement is 15% and a commercial bank receives a new deposit of Rs.2000. Which of the following changes will occur in the bank's balance sheet as a result of this?

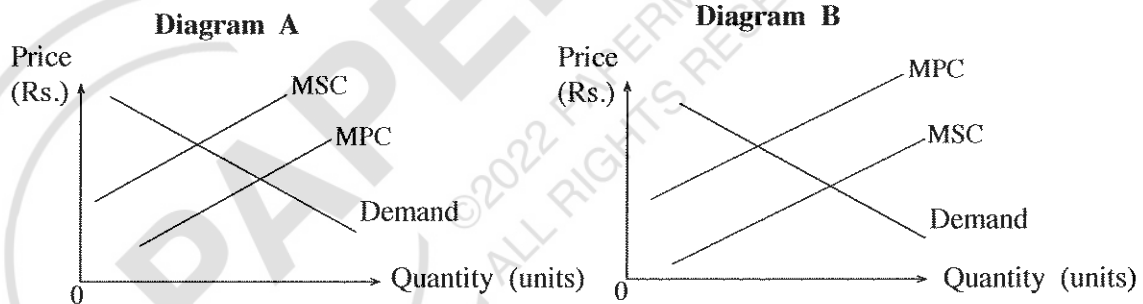
	Liabilities	Required Reserves
(1)	Increase by Rs. 2 000	Increase by Rs. 1 700
(2)	Increase by Rs. 2 000	Increase by Rs. 300
(3)	Increase by Rs. 2 000	Not change
(4)	Decrease by Rs. 2 000	Decrease by Rs. 300
(5)	Increase by Rs. 2 000	Decrease by Rs. 1 700

(.....)

34. A public good is

- (1) a good that the general public must pay for.
- (2) non-rival in consumption.
- (3) more costly than a private good.
- (4) a good that generate positive externalities.
- (5) a good that generates negative externalities. (.....)

35. The diagrams below display two competitive markets for good 'A' and good 'B'. MSC is marginal social cost and MPC is marginal private cost.



Based on the two diagrams, it can be correctly concluded that

- (1) both diagrams demonstrate the existence of externalities.
- (2) both diagrams demonstrate the existence of negative externalities.
- (3) both diagrams demonstrate the existence of positive externalities.
- (4) diagram A demonstrates inefficiency through underproduction.
- (5) diagram B demonstrates inefficiency through overproduction. (.....)

36. 'Government failure' occurs when

- (1) social costs in a market are greater than social benefits.
- (2) the government fails to intervene in the market.
- (3) externalities exist in the market.
- (4) a government intervention leads to a net welfare loss compared to the free market solution.
- (5) the government fails to remove production inefficiency and allocative inefficiency. (.....)

37. When a progressive income tax rate structure is in operation, the rich pay  
 (1) a lower percentage of their income in taxes than the poor.  
 (2) a smaller rupee amount in taxes than the poor.  
 (3) a fixed percentage of their income in taxes whatever the level of income.  
 (4) a gradually increasing percentage of income in taxes as income increases.  
 (5) a gradually decreasing percentage of income in taxes as income increases. (.....)
38. What was the outstanding public debt of the central government of Sri Lanka as a percentage of GDP in 2017 and 2018?

	2017	2018
(1)	76.9	82.9
(2)	79.1	80.2
(3)	80.0	90.0
(4)	74.5	85.0
(5)	78.5	79.5

(.....)

39. Which of the following countries entered into a free trade agreement with Sri Lanka most recently?  
 (1) India (2) China (3) Bangladesh (4) Singapore (5) Pakistan (.....)
40. The Table below shows data related to the commodity terms of trade index for a country.

Year	Commodity Terms of Trade Index
2014	100
2016	110
2018	134

It can be concluded from the data given in the above Table that for the period 2014 - 2018,

- (1) export prices rose relatively faster than import prices.  
 (2) import prices rose relative to export prices.  
 (3) the volume of exports exceeded the volume of imports.  
 (4) the volume of exports rose faster than the volume of imports.  
 (5) the balance of trade surplus increased. (.....)
41. Consider that Canada provides a financial grant to build a reservoir to generate hydropower in a developing country. This will be entered in Canada's Balance of Payments as a  
 (1) debit in the capital account. (2) debit in the financial account.  
 (3) debit in the service account. (4) credit in the primary income account.  
 (5) credit in the secondary income account. (.....)
42. What is likely to be the effect of a depreciation of a country's currency?  
 (1) An increase in the rate of inflation. (2) A decrease in the profit margin of exports.  
 (3) An increase in unemployment. (4) An improvement in the terms of trade.  
 (5) An increase inflow of foreign capital funds. (.....)
43. Assume that under a fixed exchange rate system, a country's rate of inflation increases relative to its trading partners. What are the most likely changes on imports and exports as a result of this?

	Imports	Exports
(1)	Decrease	Decrease
(2)	Decrease	Increase
(3)	Increase	Decrease
(4)	Increase	Increase
(5)	Unchanged	Unchanged

(.....)

44. The Human Development Index (HDI) summarizes a great deal of social performance into a single composite index, combining
- (1) disparity reduction rate, human resource development rate and the literacy rate.
  - (2) longevity, education and living standard.
  - (3) minimum schooling, adult literacy and tertiary educational attainment.
  - (4) human resource training, development and innovations.
  - (5) infant mortality, adult literacy and per capita income. (.....)
45. International poverty line for lower middle income countries is
- (1) US dollar 1.25. (2) US dollar 1.90. (3) US dollar 3.20.
  - (4) US dollar 5.50. (5) US dollar 21.70. (.....)
46. According to the Poverty Headcount Index in 2016, the districts with lowest and highest poverty levels in Sri Lanka were respectively,
- (1) Gampaha and Mullaitivu. (2) Colombo and Kilinochchi.
  - (3) Gampaha and Batticaloa. (4) Colombo and Trincomalee.
  - (5) Hambantota and Vavuniya. (.....)
47. A redistribution of income from the richest 10% of society towards the poorest 10% will
- (1) increase the Gini coefficient and move the Lorenz curve closer to the 45 degree line.
  - (2) decrease the Gini coefficient and move the Lorenz curve closer to the 45 degree line.
  - (3) decrease the Gini coefficient and move the Lorenz curve further from the 45 degree line.
  - (4) increase the Gini coefficient and move the Lorenz curve further from the 45 degree line.
  - (5) increase the Gini coefficient and the Lorenz curve lies on the 45 degree line. (.....)
48. The Table below shows labour market data for a hypothetical economy.

Year	Number of persons employed (million)	Labour force (million)	Household population aged 15 and above (million)
2017	27	30	60
2018	32	36	80

Based on this data, which one of the following statements is correct?

- (1) The labour force participation rate in 2018 was lower than that in 2017.
  - (2) The rate of unemployment in 2018 was lower than that in 2017.
  - (3) The labour force participation rate in 2018 was higher than that in 2017.
  - (4) The labour force participation rate in 2018 was exactly the same as that in 2017.
  - (5) The rate of unemployment in 2018 was exactly the same as that in 2017. (.....)
49. The total dependency ratio in Sri Lanka is defined as the
- (1) percentage of population over 65 years of age.
  - (2) ratio of number of children to adults in the population.
  - (3) percentage of population below 10 years and above 60 years of age.
  - (4) percentage of population below 15 years and above 64 years of age.
  - (5) ratio of non-working age population to working age population. (.....)
50. According to the Household Income and Expenditure Survey in 2016, the income shares of richest 20% and the poorest 20% of households in Sri Lanka are respectively
- (1) 50.8% and 4.8%. (2) 45.1% and 4.5%. (3) 54.1% and 6.1%.
  - (4) 62.3% and 3.2%. (5) 53.3% and 5.6%. (.....)



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පැරණි නිර්දේශය/பழைய பாடத்திட்டம்/Old Syllabus

ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව  
 தலைக்களம் இலங்கைப் பரீட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம் இலங்கைப் பரීட்சைத் திணைக்களம்  
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 Department of Examinations, Sri Lanka

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අධ්‍යයන පොදු සහතික පත්‍ර (උසස් පෙළ) විභාගය, 2019 අගෝස්තු  
 கல்விப் பொதுத் தராதரப் பத்திர (உயர் தர)ப் பரீட்சை, 2019 ஓகஸ்ட்  
 General Certificate of Education (Adv. Level) Examination, August 2019

ආර්ථික විද්‍යාව II  
 பொருளியல் II  
 Economics II

21 E II

06.08.2019 / 1300 - 1610

භූය නූතයි  
 மூன்று மணித்தியாலம்  
 Three hours

අමතර කියවීමේ කාලය - මිනිත්තු 10 යි  
 மேலதிக வாசிப்பு நேரம் - 10 நிமிடங்கள்  
 Additional Reading Time - 10 minutes

Use additional reading time to go through the question paper, select the questions and decide on the questions that you give priority in answering.

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) To which category of productive resources does each of the following belong?
  - (a) An unemployed worker
  - (b) Lakvijaya coal power plant
  - (c) A tea estate in Nuwara Eliya
  - (d) Sinharaja forest (04 marks)
- (ii) What are the assumptions on which the production possibilities curve is based? (04 marks)
- (iii) Explain, how increasing opportunity costs are reflected in the production possibilities curve. How would the curve appear if opportunity costs were constant? Explain your answers with diagrams. (04 marks)
- (iv) What are the criteria used in the classification of economic systems? (04 marks)
- (v) Explain briefly, the conditions required to achieve economic efficiency of the allocation of resources? (04 marks)
2. Suppose the demand and supply curves for a product sold in a competitive market are represented by the following equations.
 

Demand equation:  $Q_D = 100 - 2P$       Supply equation:  $Q_S = -30 + 3P$

  - (i) Find the equilibrium price and the quantity for the product. (04 marks)
  - (ii) Calculate the price elasticity of demand at the market equilibrium. (04 marks)
  - (iii) Suppose now the government has decided to grant a subsidy of Rs.5 per unit for the producers of this product. Calculate the market equilibrium price and the quantity of this product after the subsidy granted. (04 marks)
  - (iv) Compare the economic surplus before and after the subsidy. (04 marks)
  - (v) What can you conclude on the allocative efficiency of resource allocation in this market after the introduction of the subsidy? (04 marks)

3. (i) Explain how diminishing marginal returns and decreasing returns to scale affect a firm's production cost. (04 marks)
- (ii) What effect would each of the following have on a firm's short-run marginal cost curve and its total fixed cost curve?
- An increase in the wage rate
  - A decrease in property taxes
  - A rise in the purchase price of new capital equipment
  - A rise in energy prices
- (04 marks)
- (iii) What factors are considered in determining the market structure of a particular industry? (04 marks)
- (iv) What type of demand curve does a perfectly competitive firm face? Explain reasons. (04 marks)
- (v) A perfectly competitive firm could face each of the following situations in the short run. In each case, indicate whether the firm should produce in the short run or shut down in the short run, or whether additional information is needed to determine what it should do in the short run.
- Total cost exceeds total revenue at all output levels.
  - Total variable cost exceeds total revenue at all output levels.
  - Total revenue exceeds total fixed cost at all output levels.
  - Price exceeds average total cost at all output levels.
- (04 marks)
4. (i) Explain, how it is possible to measure Gross Domestic Product by using either the expenditure approach or the income approach, when neither of these approaches actually measures production. (04 marks)
- (ii) Why are changes in inventories/stocks included as a part of investment spending? (04 marks)
- (iii) What are the main components of expenditure considered in measuring Gross Domestic Product using expenditure approach? (04 marks)
- (iv) Define each of the following terms.
- Gross National Income
  - Gross National Disposable Income
  - Personal Income
  - Disposable Personal Income
- (04 marks)
- (v) "National income statistics are a powerful tool of economic understanding and analysis." Explain. (04 marks)
5. (i) What is meant by marginal propensity to consume (MPC)? Why is it less than one? (04 marks)
- (ii) Why is the value of the multiplier positively related to the marginal propensity to consume? (04 marks)
- (iii) Aggregate consumption expenditure of a hypothetical economy is represented by the following equation.
- $$C = 50 + 0.75 Y_D$$
- Further assume that investment expenditure at every level of income is Rs. 700 billion, net exports are zero. The government budget is balanced with government purchases and taxes equal to Rs. 500 billion each.
- Calculate the equilibrium level of GDP. (02 marks)
  - If the potential GDP is Rs. 5000 billion, is there a deflationary or inflationary gap in the economy? If so, how much? (02 marks)
- (iv) What is the multiplier effect? Use a 45° line diagram to illustrate the multiplier effect of a decrease in government purchases. (04 marks)
- (v) Why does real GDP change by a larger amount from changes in government purchases than from tax changes? (04 marks)

**Sub section 'B'***(Select minimum of two questions from this section.)*

6. (i) State the equation of exchange and identify each variable. (04 marks)
- (ii) "Inflation is triggered by excess demand but sustained by rising costs". Explain this statement using diagrams. (04 marks)
- (iii) What are the criteria that money should fulfil to serve as an effective medium of exchange? (04 marks)
- (iv) Name **four** main institutions comprising Sri Lanka's financial system. (04 marks)
- (v) Identify the components of monetary aggregates  $M_{2b}$  and  $M_4$ . (04 marks)
7. (i) What divergences arise between equilibrium output and socially optimal output when negative externalities and positive externalities are present? Explain your answer with diagrams. (04 marks)
- (ii) Using examples, explain the characteristics of quasi-public goods and merit goods. (04 marks)
- (iii) Name the main components of recurrent expenditure of the government of Sri Lanka. (04 marks)
- (iv) What is meant by 'excess burden of taxation'? Using a diagram, explain the excess burden of a production tax on a commodity which has an inelastic demand with respect to price. (04 marks)
- (v) Name the widely used sources and instruments in financing the budget deficit in Sri Lanka during the last three years. (04 marks)
8. (i) Suppose country A can produce 80 units of good X or 60 units of good Y by using all its resources. Comparable figures for country B are 60 units of good X and 60 units of good Y.
- (a) Assuming constant costs state in which product should each country specialize, based on comparative advantages. (02 marks)
- (b) For mutually beneficial trade to occur, what should be the limits of the terms of trade between good X and good Y? (02 marks)
- (ii) Name **four** free trade agreements ratified by Sri Lanka. (04 marks)
- (iii) What are the reasons for Sri Lanka's trade deficit to widen substantially over the last five years? (04 marks)
- (iv) The Table below shows components of the Balance of Payments for a hypothetical economy.

Components of the Balance of Payments	Rs. billion
Trade balance	-960
Services (net)	340
Primary income (net)	-230
Secondary income (net)	630
Capital account (net)	20

- (a) What is the balance on the Current Account? (02 marks)
- (b) What is the balance on the Financial Account? (02 marks)
- (v) What are the disadvantages of freely fluctuating exchange rates that led countries to the managed floating exchange rate system? (04 marks)

*[See page four*

9. (i) What is meant by the concept of 'productivity'? What are the main determinants of productivity? (05 marks)
- (ii) "Growth in per capita Gross National Income (GNI) is not an adequate measure of quality of life." Explain. (05 marks)
- (iii) What is Human Development Index? What are its advantages and disadvantages over other measures of development? (05 marks)
- (iv) What are the causes of extreme poverty in Sri Lanka? (05 marks)
10. (i) Describe briefly, how the development policies in Sri Lanka after independence have changed with the political regimes. (05 marks)
- (ii) "The postponement of the much needed structural reforms has moved the Sri Lankan economy to a very low growth path at present." What are these growth-enhancing reforms that Sri Lanka has delayed implementation? (05 marks)
- (iii) Mention the shortcomings of the investment climate and factor markets which pose obstacles for investments in Sri Lanka. (05 marks)
- (iv) "Sri Lanka's public debt remains very high and at the same time the debt portfolio indicates some significant risks on debt sustainability." Explain this statement especially focusing on the size and the composition of public debt in Sri Lanka. (05 marks)

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