

ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව
இலங்கைப் பரீட்சைத் திணைக்களம்

අ.මො.ම. (උ.මෙල) විභාගය/ க.மொ.த. (உயர் தர)ப் பரீட்சை - 2022 (2023)

ප්‍රශ්න පාඨය
பாட இலக்கம்

21

විෂය
பாடம்

ECONOMICS

ලකුණු දීමේ පටිපාටිය/புள்ளி வழங்கும் திட்டம்

I ප්‍රශ්න/பத்திரம் I

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

මෙම ලකුණු/ விசை அறிவுறுத்தல் :

එක් පිළිතුරකට/ ஒரு சரியான விடைக்கு 01 ලකුණ දීම/புள்ளி வீதம்

මුළු ලකුණු/மொத்தப் புள்ளிகள் 01 x 50 = 50

ශ්‍රී ලංකාවේ විභාග දෙපාර්තමේන්තුව
இலங்கைப் பரீட்சைத் திணைக்களம்
Department of Examinations, Sri Lanka

අධ්‍යයන පොදු කායික පත්‍ර (උසස් පෙළ) විභාගය, 2022 (2023)
கல்விப் பொதுத் தராதரப் பரீட்சை (உயர் தர)ப் பரீட்சை, 2022 (2023)
General Certificate of Education (Adv. Level) Examination, 2022 (2023)

ඉංග්‍රීසි විද්‍යාව	II
භෞතික විද්‍යාව	II
Economics	II

21 E II

පරීක්ෂණ කාලය
පරීක්ෂණ කාලය
Three hours

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

Use additional reading time to go through the question paper, select the questions you will answer and decide which of them you will prioritise.

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'

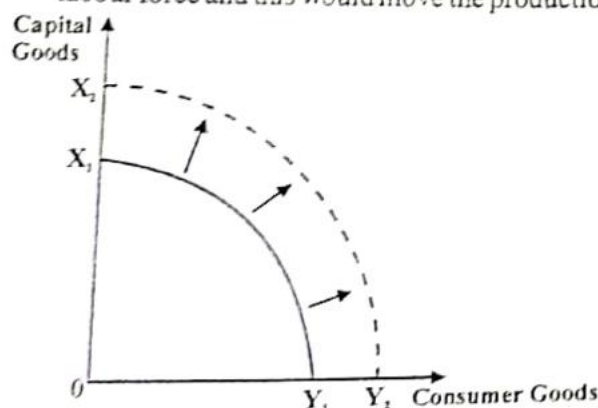
(Select minimum of two questions from this section.)

- 01-
1. (i) "If resources were unlimited and freely available, there would be no subject called economics." Explain this statement. *Choice should be highlighted* (04 marks)
- (ii) Briefly describe using separate diagrams how each of the following events can be illustrated in production possibilities curves of a country
- (a) The quality of education increases.
 - (b) Real Gross Domestic Product has contracted by 8% causing increase in the rate of unemployment.
 - (c) Defence spending reduced allowing government to spend more on health services.
 - (d) Prolonged drought has resulted long periods of power cuts.
 - (e) Limiting the availability of foreign exchange to import essential raw materials for industrial production.
- (iii) Name five disadvantages of a free market economic system. (05 marks)
- (iv) Explain the role of technology and entrepreneurs in the utilization of economic resources of a country. (05 marks)

- (i) - Economics is the study of scarcity and choice. Every economic issue involves, at its most basic level, individual choice - decisions by individuals about what to do and what not to do. In fact, you might say that it isn't economics if it isn't about choice. (02 marks)

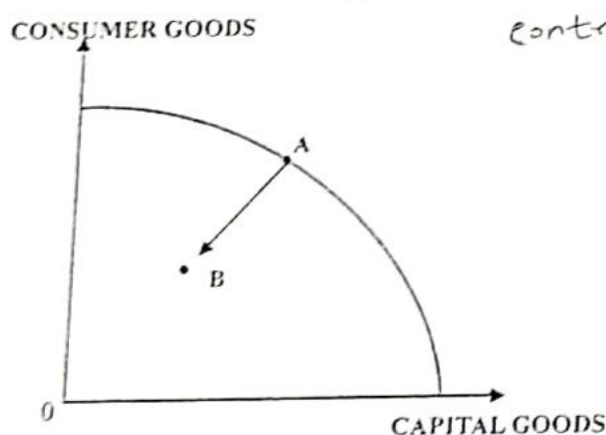
- If resources were unlimited and freely available, making choices would not be necessary. Every person could have as much as they wanted of any good or service. Economics, the science of choice, would be unnecessary. (02 marks)

- (ii) (a) An increase in the quality of education enhances the productivity of the country's labour force and this would move the production possibilities curve outward.



(Correct diagram with correct description 01 mark)

- (b) This does not affect the location of the production possibilities curve. The point of production moves further inside the curve. Production point moves from A to B.



contraction of the economy

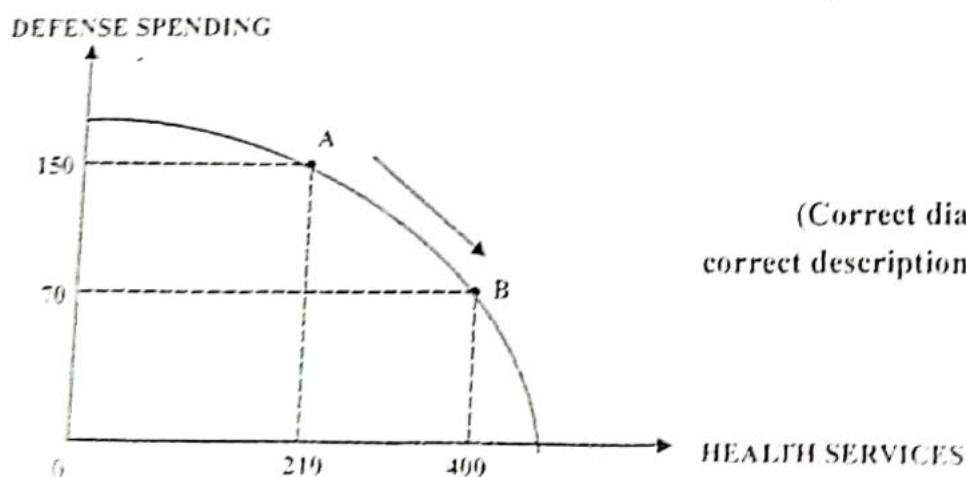


(Correct diagram with correct description 01 mark)

Recession.

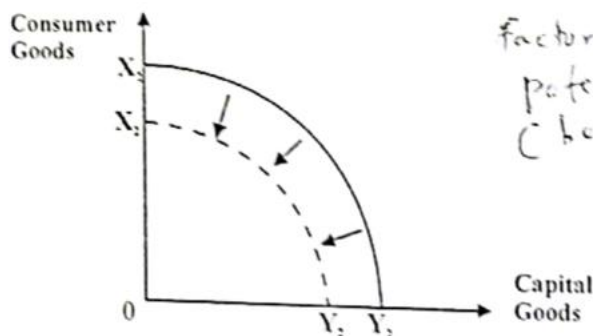
- (c) This does not affect location of curve. Resources are allocated away from one type of government spending toward another (health care).

a movement along PPC, does not shift in PPC.



(Correct diagram with correct description 01 mark)

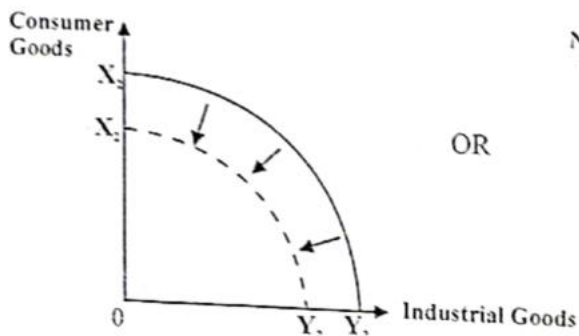
- (d) The loss of power supply means depletion of country's resource endowment. This would move the production possibilities curve inward.



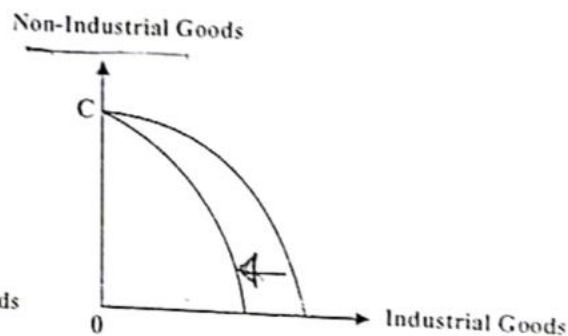
factor endowment decreases
potential output decreases
(both sectors)

(Correct diagram with correct description 01 mark)

- (e) Limiting the availability of foreign exchange means reduction of country's productive resources. This would move the production possibilities curve inward.



OR



(Correct diagram with correct description 01 mark)
both should be there.

- (iii) - Free market activity can lead to a rise in the scale of income and wealth inequality
- Businesses can develop monopoly power which leads to higher prices and damage to consumer welfare
 - Under-provision or non-provision of public goods
 - Under-provision of merit goods such as health and education
 - Free markets may fail to address negative externalities from production and Consumption
 - Markets may be sluggish or volatile due to poor information and deficiencies arising from the behaviour of markets over time.

Add: It encourages consumerism (eg. adv. & sales promotions)
Then agree more opportunities for corruption

- The primary objective of every business in a free market economy is to earn as much profit as possible. Most situations will see an organization deciding to sacrifice worker safety, compromise on environmental standards, and act without ethics because no controls are in place to govern their behavior.
- Macroeconomic instability
- Deregulated financial markets often prone to bouts of instability – the fall out from which affects millions not directly involved.

(01 mark each for any disadvantage; Total marks 05)

Technology:

- Technology encompasses a huge body of knowledge and tools that ease the use of economic resources as a way to produce goods and services efficiently and innovatively.
- Technology can save the time it takes to produce a good or deliver a service, The saved time can be utilized by employees in the workplace to produce something very productive contributing to the overall profits of a business.
- Technology has led to an increase in the division of labor and specialization of jobs within a business, further contributing to the efficiency with which a business is able to run.
- Efficient communication of employees through Technology results in increased productivity in so many ways.
- Technology enables easy access to the latest information
- It gives opportunities for sustainable resource use

(01 mark each for any three reasons; 03 marks)

Entrepreneurs:

- Technological progress alone cannot lead to expansion of output, unless technological breakthroughs are put to economic use by entrepreneurs.
- Identification of opportunities for productive activities
gaps, unmet demand & enables efficient resource allocation
- Unutilized resources, labor, and capital are utilized most efficiently by entrepreneurs.
- By bringing innovation to every aspect of businesses, entrepreneurial ventures enhance production utilizing the existing resources in the most effective ways.
- Expands the production boundary by taking more risks
- Entrepreneurs develop new markets by introducing new and improved products, services, and technology.
- Entrepreneurship improves productivity – entrepreneurship injects the economy with a fresh batch of higher productivity firms, increases competition among existing businesses, and pushes out less-productive ones

(01 mark each for any three reasons; 03 marks)

(Total marks 06)

02	(03 marks)
2 (i) What is held constant in drawing a supply curve?	
(ii) Research studies indicate that the price elasticity of demand for cigarettes is about -0.75. If a pack of cigarettes currently costs Rs. 1500 and the government wants to reduce smoking by 30%, how much should be the price of a pack of cigarettes?	(05 marks)
(iii) List and briefly describe any three non-price rationing systems.	(06 marks)
(iv) Explain why consumers demand less of a commodity as its price rises.	(06 marks)

2. (i) - The prices of factors of production
 - The prices of related goods produced
 - Expected future prices
 - The number of suppliers
 - Technology
 - The state of nature (Natural factors) if the price of the product is then zero marks.
- (01 mark each for any three factors; Total marks: 03)

- (ii) The formula for price elasticity of demand:

$$\frac{(\text{Percentage change in Quantity Demanded})}{(\text{Percentage change in Price})} = \Sigma = -0.75$$

(01 mark)

- 1% change in price causes 0.75% change in quantity demanded.
 - What is the required price change for 1% change in quantity demanded?
 - It should be $= \frac{(1.00\%)}{(0.75\%)} = \frac{100}{75} = \frac{4}{3} = 1 \frac{1}{3}$
 - If the quantity demanded to be changed by 30%, price needs to be changed by $30 \times 1 \frac{1}{3} = 40\%$
- OR
- $$\frac{(1.00\%)}{(0.75\%)} \times 30\% = \frac{100}{75} \times 30 = 40\%$$
- (02 marks)
- Current price of a pack of cigarettes = Rs. 1500
 - To reduce the quantity demanded by 30% price needs to be increased by 40%. Thus, a pack of cigarettes has to be increased by Rs. 600 (= 1500 x 40%).
 - The price of a pack of cigarettes should be 1500 + 600 = Rs. 2100.00

(02 marks)

(Total marks 05)

1 - **Queuing:** A queue is a waiting line that solves the rationing problem on a first-come, first-served basis. Queuing does not have to consist of getting physically in line. Queuing can be by putting one's name on a waiting list for a commodity where there is excess demand.

- **Rationing coupons:** Tickets or coupons that entitle individuals to purchase a certain amount of a given product per month.

- **Favoured customers:** Those who receive special treatment from dealers during situations of excess demand. Favoured persons may be friends, customers of long standing, or perhaps those who buy other goods which are proving difficult to sell.

- **Black market:** A market in which illegal trading takes place at market determined prices. The maximum price limit is illegally broken. The incentive to break the law is present as consumers would be prepared to pay more than free market equilibrium price.

- **Chance allocation:** In the absence of any of the above methods, resource allocation might be, in a sense, haphazard. For example, some goods for which there is excess demand suddenly and unexpectedly appear in some shops. Those persons who happened to be present at the moment of arrival would then be likely to benefit.

ii) **Lottery system (02 marks for each for any three methods; Total marks 06)**
Allocation based on needs (Eg. C & R) - Need based.

iv) - There is an inverse relationship between the quantity demanded and the price of the commodity. This relationship is described as the Law of Demand. There are two reasons for consumers to demand less of a commodity as its price rises.

(a) substitution effect (b) income effect

(02 marks)

- **Substitution effect:** When the price of a good rises, other things remain the same, its relative price rises. People buy less of a relatively expensive commodity and buy (substitute) more of its relatively cheap substitutes.

(02 marks)

- **Income Effect:** When the price of the good rises, other things remaining the same, consumers' real income (purchasing power of his money income) falls. They cannot afford to buy all the things they previously bought. Therefore, they must decrease the quantities demanded of normal goods.

(02 marks)

(Total marks 06)

03

3. (i) Why do prices of agricultural products fluctuate more than the prices of industrial goods? (06 marks)
- (ii) If a price floor benefits producers, why does a price floor reduce economic surplus? Explain your answer using a diagram. (06 marks)
- (iii) Suppose the demand and supply curves for a product sold in a competitive market are represented by the following equations.
- Demand: $Q_D = 720 - 4P$ Supply: $Q_S = -120 + 2P$
- (A) Find the equilibrium price and quantity of the product. (02 marks)
- (B) Suppose now government has decided to grant a subsidy of Rs. 15 per unit for the producers of this product.
- (a) What is the price paid by the buyer after the subsidy? (03 marks)
- (b) What is the price received by the supplier after the subsidy? (03 marks)

3. (i) - Compared with the demand for industrial goods, the demand for agricultural goods is inelastic with respect to both price and income. With inelastic demand, a change in supply causes relatively large changes in price.

- In the short run, unlike industrial goods, the supply of agricultural products is inelastic due to maturity lag. If price rises, farmers cannot respond to by increasing supply immediately. It will take 1-5 years before new plants start to produce crop.

- Compared to industrial goods, production responsiveness is low for annual crop commodities because planting decisions are made before prices for the new crop are known. These decisions depend on expected prices and not price realizations. Price outcomes are seldom so disastrous as to result in the harvest being abandoned.

→ Global market dynamics (weather, maize, cotton etc. - world market changes)

- In contrast to industrial production, the supply of agricultural products can be variable depending on several natural factors (weather, disease) beyond the control of producers. Good weather can lead to an unexpectedly large increase in supply which can lead to glut on the market and falling prices. Also disease and pests can affect the supply resulting price fluctuations.

→ government policies & intervention instruments of export import management

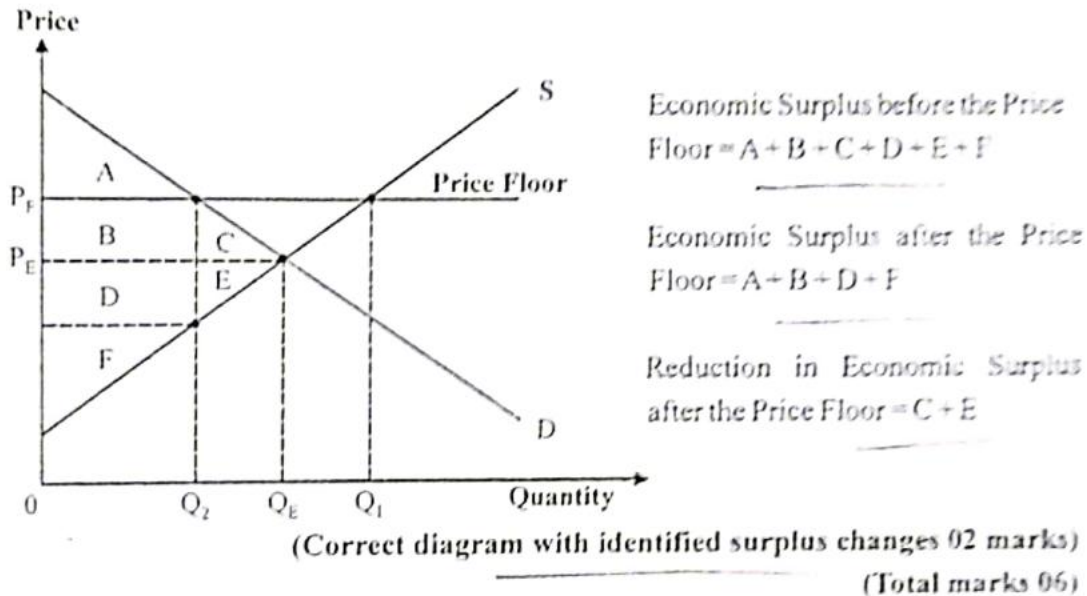
- Compared to industrial goods, most of the agricultural crops are non-durable (perishable) nature and individual farmers may be unable to accumulate stocks.

(02 marks each for any three reasons; Total marks 06)

- (ii) - If the government sets the price floor which is more than equilibrium price level, then it will benefit the producers as they would get more than the market clearing price level. Therefore, the producer surplus rises and consumer surplus falls.

(02 marks)

- Also, if the price floor or minimum price level is set above the equilibrium price level then there will be more of supply and less of demand and price cannot go below the minimum price level set by the government. So, market would not achieve equilibrium position. As a result, there will always be a dead weight loss represented by the area C + E in the diagram below which reduces the economic surplus in the society. (02 marks)
- Diagram showing loss of economic surplus under floor price:



- (iii) (A) $Q_D = Q_S$
- $720 - 4P = -120 + 2P$
- $840 = 6P$
- $140 = P$ Equilibrium price (01 mark)
- $Q = 720 - 4(140)$
- $Q = 720 - 560 = 160$ Equilibrium quantity (01 mark)

- (B) (a) Price paid by the buyer :-
- After the subsidy buyers price (P_b) = Sellers price (P_s) - Subsidy
- After the two subsidy seller's price (P_s) = Buyer's price (P_b) + Subsidy (01 mark)
- $720 - 4P_b = -120 + 2P_s$
- $720 - 4P_b = -120 + 2(P_b + 15)$ (01 mark)
- $720 - 4P_b = -120 + 2P_b + 30$
- $720 + 120 - 30 = 4P_b + 2P_b$
- $810 = 6P_b$
- $135 = P_b$ buyer's price = 135 (01 mark)
- (b) - After the subsidy seller's price (P_s) = Buyer's price (P_b) + Subsidy (01 mark)
- Seller's price = Buyer's price (P_b) + Subsidy
- Seller's price = $135 + 15 = 150$ (02 marks)
- (Total marks 06)

04

4. (i) Explain the difference between decreasing returns to scale and diminishing returns to a variable factor. (02 marks)
- (ii) "Jayantha currently works as a lawyer at a legal consultancy firm earning a monthly salary of Rs. 250,000 is considering to start his own legal consultancy firm where he expects to earn Rs. 300,000 per month. He would need an office and a clerk to run his own firm. He has found the office which rents for Rs. 50,000 a month. Further, he could hire a clerk for Rs. 40,000 a month." If these figures are accurate, would Jayantha's legal consultancy firm be able to earn an economic profit? Explain your answer. (04 marks)
- (iii) State four main features of a perfectly competitive industry? (04 marks)
- (iv) Assume a perfectly competitive paddy market. Firms in the market are producing paddy, but they are currently incurring economic losses.
- (a) Compare the market price of paddy relevant to this situation with firms' average total cost (ATC), average variable cost (AVC) and marginal cost (MC). (03 marks)
- (b) Draw two graphs, side by side, to reflect the current situation in the market and for the typical firm. (05 marks)

4. (i) - Decreasing returns to scale relates to the long run when all inputs become variable. Diminishing returns to a variable factor refers to the short run when you add more variable factors while holding fixed inputs unchanged. (02 marks)

- Decreasing returns to scale refers to the efficiency of increasing fixed factors (scale of the plant). Diminishing returns to a variable factor relates to the efficiency of adding a variable factor of production to a given quantity of fixed inputs. (02 marks)

(ii) - Economic profit = Total revenue - Total economic cost (opportunity cost)
 Total Revenue of Jayantha's own consultancy firm = Rs. 300,000
 Total cost = Explicit costs + Implicit costs
 Explicit costs = Rent + Clerk's salary = 50,000 + 40,000 = 90,000
 Implicit costs = Foregone salary of Jayantha's previous job = 250,000
 Total cost = 90,000 + 250,000 = 340,000 (02 marks)

- Economic profit = Total revenue - Total economic cost
 Economic profit = 300,000 - 340,000 = -40,000
 - Jayantha's own firm would not be able to earn an economic profit as its total cost exceeds total revenue. (02 marks)

(iii) The main features of a perfectly competitive industry: (Total marks 04)

- A large number of buyers and sellers
- Homogenous products
- Free exit and entry of firms
- Perfect knowledge among buyers and sellers (01 mark each and total marks 04)

(iv)(a) – When the firms continue to produce paddy while incurring economic losses, the average total cost (ATC) of the firms should be above the market price of paddy.

(01 mark)

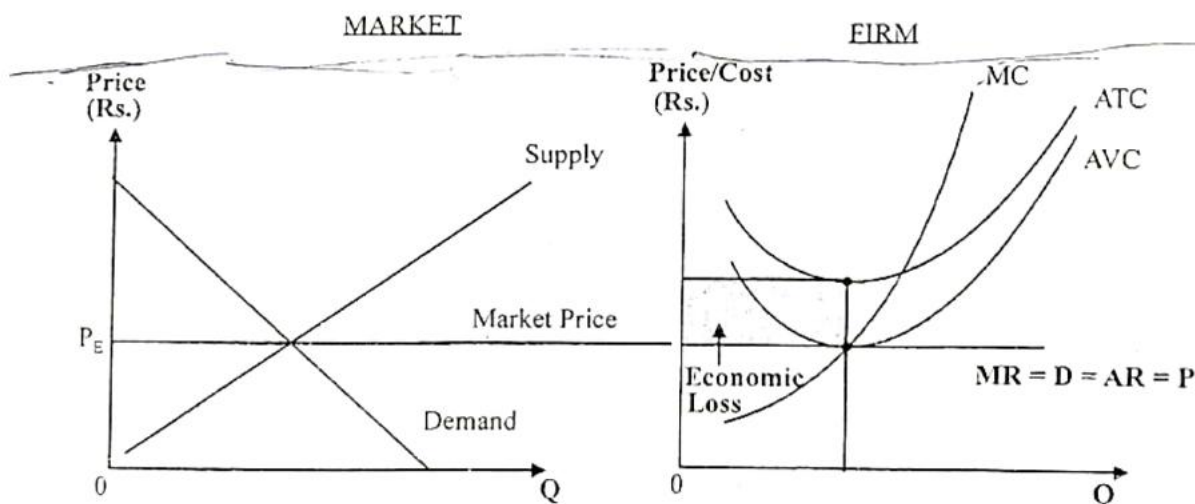
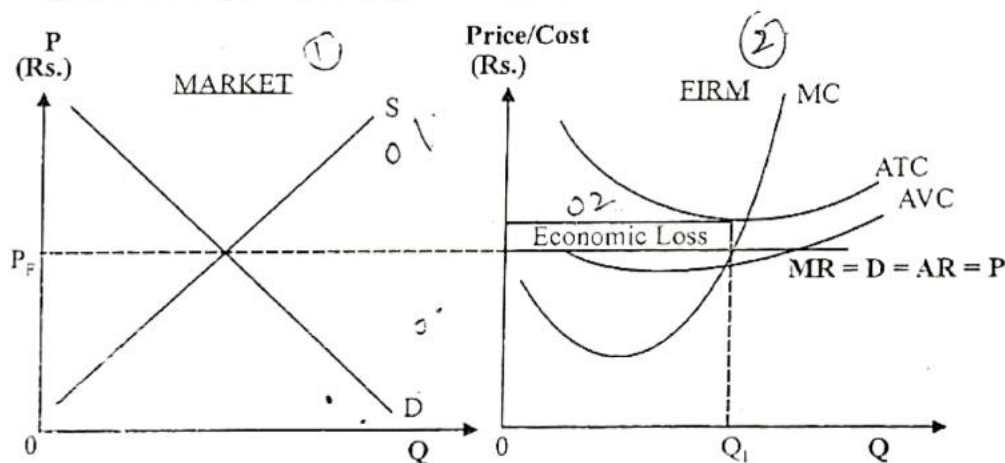
- When the firms continue to produce paddy while incurring economic losses, the average variable cost (AVC) of the firms should be below the market price of paddy. Sometimes, the firms may continue to operate while incurring economic losses even when the the average variable cost is just equal to the market price (shut down point) if they expect market condition will improve in the near future.

(01 mark)

- When the firms continue to produce paddy while incurring economic losses, the marginal cost (MC) of the firms should be equal to the market price of paddy.

(01 mark)

(b) Diagrams showing the current situation of the market



(Market diagram with correct labeling 01 mark; Firm diagram with correct labeling 02 marks; Showing the economic loss in the firm's diagram 02 mark; Total marks 05)

05

5. (i) Define Nominal Gross Domestic Product, Real Gross Domestic Product and Gross Domestic Product per capita. (03 marks)
- (ii) Does the Gross Domestic Product an over-estimate or under estimate of all production activities in an economy? Explain your answer. (04 marks)
- (iii) The table below illustrates the consumption function for a household.

Disposable Income (Rs.)	Consumption Expenditure (Rs.)
0	3 000
3 000	5 400
6 000	7 800
9 000	10 200
12 000	12 600
15 000	15 000
18 000	17 400

- (a) Compute the household's Average Propensity to Consume (APC) at the disposable income levels of Rs. 9 000 and Rs. 18 000 and the Marginal Propensity to Consume (MPC) at that range of disposable income. (04 marks)
- (b) Write the equations for the household's consumption and saving functions. (04 marks)
- (c) From the information given, draw the household's consumption and saving

5. (i) - Nominal Gross Domestic Product is the monetary value of final goods and services produced in a country in a given period of time (normally a quarter or a year) using the prices of goods and services at the time of production.

OR

- Nominal Gross Domestic Product is the sum of value added at current basic prices by all resident institutional units in the economic territory plus taxes on products less subsidies on products at the time of production.

(01 mark)

- Real Gross Domestic Product is a country's G.P. adjusted to reflect changes in the price level. (01 mark)

- Gross Domestic Product per capita is the value of nominal or real GDP, divided by mid-year population of the country. (01 mark)

(Total marks 03)

(ii) **Overestimation:**

- This measure does not include, for example, environmental externalities such as pollution or damage to species, since nobody pays a price for them.
- Harmful effects of pollution and costs of pollution reduction are not deducted from GDP.
- GDP does not incorporate changes in the value of assets, such as the depletion of resources or loss of biodiversity. GDP does not net these off the flow of transactions during the period it covers.

- GDP counts 'bads' as well as 'goods'. When an earthquake or a tsunami hits and requires rebuilding, GDP increases. When someone gets sick and money is spent on their care, it's counted as GDP. But nobody would argue that we are better off because of a destructive earthquake or people getting sick.

(02 marks each for any two reasons; Total marks 04)

Underestimation:

- GDP ignores productive transactions that do not take place in organized markets. The most important example is services, such as cleaning, cooking, and providing free child care or productive transaction that people do for themselves in their own homes.

→ Voluntary services are not included.

- GDP ignores the underground economy, where transactions are not reported to official authorities to avoid taxes, and regulations or because the goods and services being produced are illegal.

→ value of leisure is not considered.

- GDP statistics fail to fully capture the benefits of technology. The place that the Internet occupies in our lives is actually greater than the official figures suggest, since certain consumer and business activities are even harder to quantify. Indeed, a country's GDP, calculated based on national accounts, cannot take into account many benefits related to free content, whether it's product commentaries, specialized blogs, social networks. Wikipedia provides all human knowledge free of charge. In GDP terms, it is worth nothing.

→ changes in the quality improvements are not captured

(iii) (a) - Average Propensity to Consume (APC) at income level Rs. 9000:

$$APC = C/Y_d = 10200/9000 = 102/90 = 1.13$$

(01 mark)

- Average Propensity to Consume (APC) at income level Rs. 18000:

$$APC = C/Y_d = 17400/18000 = 174/180 = 0.97$$

(01 mark)

- Marginal Propensity to Consume (MPC) at income range between Rs. 9000 and 18,000:

$$\Delta C / \Delta Y_d = (17400 - 10200) / (18000 - 9000) = 7200/9000$$

$$= 4/5 = 0.8$$

(02 marks)

- (b) - Household's Consumption Function: $C = a + bY_d$

Autonomous consumption (a) = 3000

Marginal Propensity to Consume (b) = 0.8

- Household's Consumption Function: $C = 3000 + 0.8Y_d$

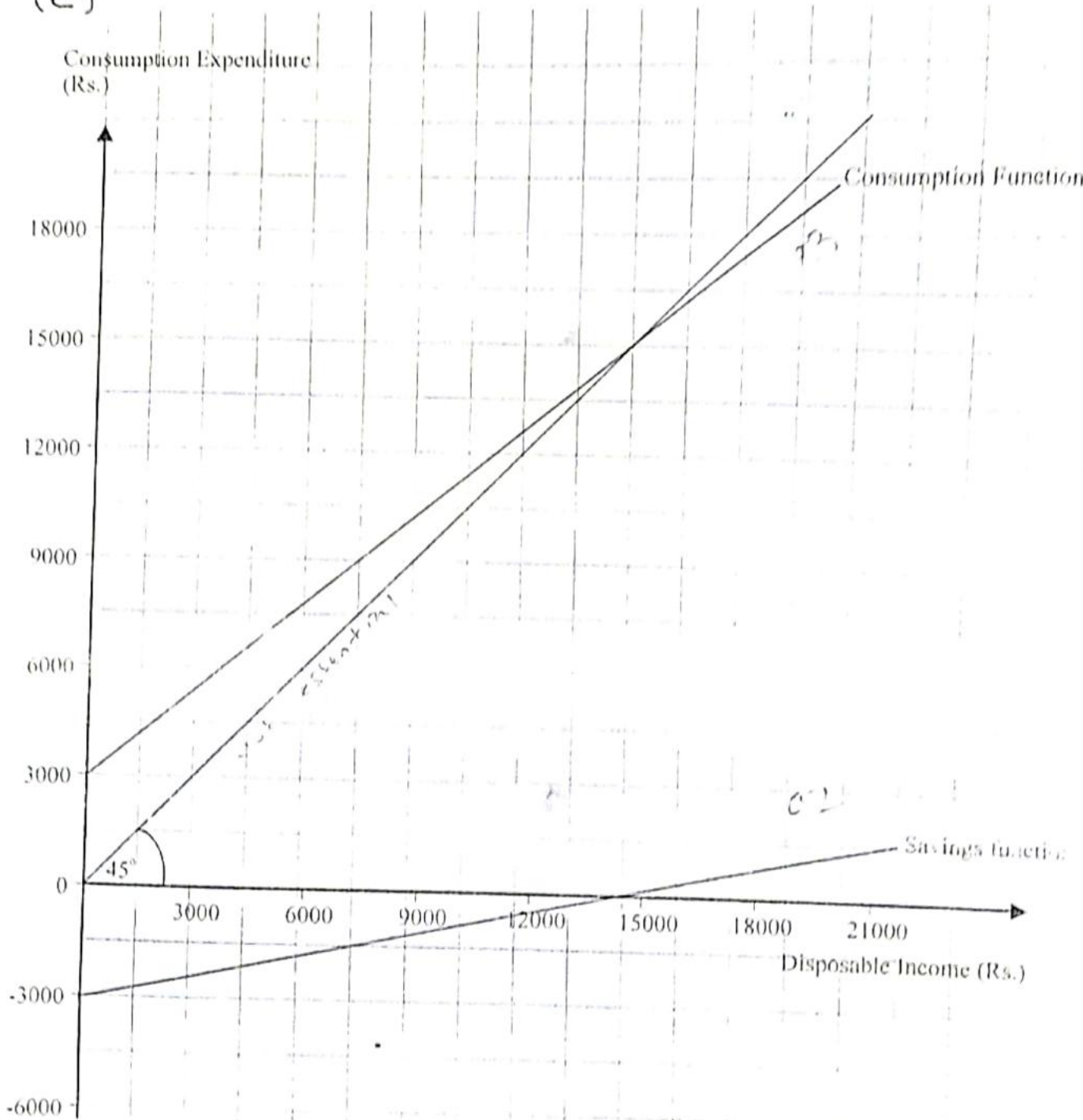
(02 marks)

- Household's Savings Function: $S = -a + (1-b)Y_d$

$$S = -3000 + 0.2Y_d$$

(02 marks)

(C)



(03 marks for the consumption function and 02 marks for the savings function;
Total marks 05)

Sub section 'B'

(Select minimum of two questions from this section.)

06

6. (i) Distinguish between near money and money substitutes. (04 marks)
- (ii) State four causes of high inflation in Sri Lanka at present. (04 marks)
- (iii) Explain the relationship between the rate of interest and the demand for money. (05 marks)
- (iv) Mention the different techniques available to the Central Bank for controlling the money supply. (07 marks)

6. (i) - Near money or quasi-money consists of highly liquid assets which are not cash but can easily be converted into cash. Near money is anything fulfills the store-of-Value function of money and it is not itself a medium of exchange (01 mark)
- Examples of near money include: Time and saving deposits, treasury bills, bonds near their redemption date, foreign currencies especially widely traded ones as the US dollar, Euro or yen. (01 mark)
- Money substitutes, on the other hand, are things that serve as the temporary media of exchange but are not stores of value. (01 mark)
- For example, a check written on a checking account at a bank is a money substitute. Further, credit cards, debit cards, token coins and electronic credit represent contemporary examples of money substitutes. Bitcoin - money crypto - virtual money. (01 mark)
- (ii) - Sharp increase in food prices can be attributed to disruptions in both global and local supply chains due to various factors that include the energy crisis, climate impacts, the pandemic and the Russia-Ukraine War.
- Domestic policy restrictions such as import bans of essential commodities, the rising cost of agricultural inputs, recent changes to agricultural policy, and the ban on chemical fertilisers and quick shift to organic fertilizer lowered agricultural production and heightened supply chain disruptions.
- The expansionary monetary policy of the government through lowered interest rates and heightened money printing contributed to higher inflation.
- An acute dollar shortage, caused by economic mismanagement and the impact of the COVID-19 pandemic, has left Sri Lanka struggling to pay for essential imports including food, fuel, fertiliser and medicine.
- Depreciation of exchange rate: Following the excessive depreciation, inflation accelerated significantly through imported prices, while second-round effects of such excessive depreciation on other goods and services were also observed subsequently.

- Decrease in total output of the economy. Negative economic growth rate.

(01 mark each for any four reasons; Total marks 04)

- (iii) - According to the speculative motive for demand for money, there is an inverse relationship between the rate of interest and the demand for money

(01 mark).

- As the interest rate falls, demand for money as an asset will rise. Price of bonds is related to the interest rate: high interest rate means low bond prices, while low interest rates mean high bond prices.

Bond Price I R (01 mark)
relationship (-)

- This variability in the price of bonds means that bond-holders can make capital gains by buying when the price is low (i.e. the rate of interest is high) and selling when the price of bonds is high (i.e. the rate of interest is low).

(01 mark)
speculative motive

- This means that holding bonds involves a risk not present when money is held. People who expect the future interest rate to fall and price of bonds to rise will be more inclined to hold bonds and lesser demand for money balances expecting a capital gain on bonds. On the other hand, people who expect the future interest rate to rise and price of bonds to fall will be more inclined to hold money expecting a capital loss on bonds.

(01 mark)

- Interest rate is the opportunity cost of holding money balances. Increase in interest rate means opportunity cost of money holdings rises. Therefore people demand less money when interest rates rise.

(01 mark) (Total marks 05)

- (iv) Central Bank possesses a wide range of techniques to be used as instruments for controlling the money supply.

- Policy interest rates
- Open market operations (OMOs)
- Statutory reserve ratio (SRR)
- Bank rate
- Refinance facilities
- Quantitative restrictions on credit
- Ceilings on interest rates and
- Cash margin requirement for letter of credit
- Loans to value ratios
- Foreign exchange operations
- Moral suasion

S D F R] instruments
S L F R]
not taken
as
No marks
for name

(01 mark each for any seven techniques; Total marks 07)

07

7. (i) Classify the following goods as either public, merit or demerit goods.
- (a) Radio transmissions
 - (b) Vaccinations
 - (c) Cigarettes
 - (d) Museums
- (04 marks)
- (ii) Compare the merits and demerits of direct and indirect taxes. (04 marks)
- (iii) (a) What is meant by incidence of taxation? (02 marks)
- (b) Distinguish between legal tax incidence and economic tax incidence. (04 marks)
- (iv) How does a negative externality in consumption affect allocative efficiency of resources? Explain your answer using a diagram. (06 marks)

7. (i) - (a) Radio transmissions - Public good
- (b) Vaccinations - Merit good
- (c) Cigarettes - Demerit good
- (d) Museums - Merit good / Quasi public (04 marks)

(ii)

Direct Taxes	
Merits	Demerits
1. More equitable. It falls on those who can afford to pay. Tends to be progressive.	1. Discourage hard work and enterprise. Encourages 'Brain drain'.
2. It is easy to determine the incidence of the tax. Shifting is difficult.	2. Discourage savings of both individuals and companies.
3. Easy to collect. i.e. PAYE system which is used to collect income tax from most wage earners.	3. Encourages tax evasion - to avoid paying so much tax
4. More important to the government's macroeconomic policy of demand management	4. There is no element of choice about paying the tax. - it is unavoidable.
	5. It creates market distortions (inflation)

(01 mark each for one merit and one demerit; total 02 marks)

Indirect Taxes	
Merits	Demerits
1. Fairly easy to collect.	1. Indirect taxes are regressive: as a proportion of income they fall more heavily on the poor.
2. Easy to determine the incidence of an indirect tax	2. Can be difficult and costly to collect
3. Can be used to discourage certain types of consumption: i.e. tobacco, alcohol	3. The amount of revenue to be raised by indirect taxes cannot easily be predicted.
4. It is a good way of raising revenue when levied on goods with inelastic demand	4. Indirect taxes may contribute to inflation.
5. No disincentive effect on work.	5. It creates market distortions

(01 mark each for one merit and one demerit; Total marks 02)

(iii)(a) - The term incidence of tax refers to the location of the ultimate or the direct money burden of the tax as such. It signifies the settlement of the tax burden on the ultimate tax payer. It in fact, is the ultimate result of shifting. Hence, the incidence of a tax is upon that person who cannot shift the burden any further. This burden can be split between buyers and sellers or different groups in the economy. (02 marks)

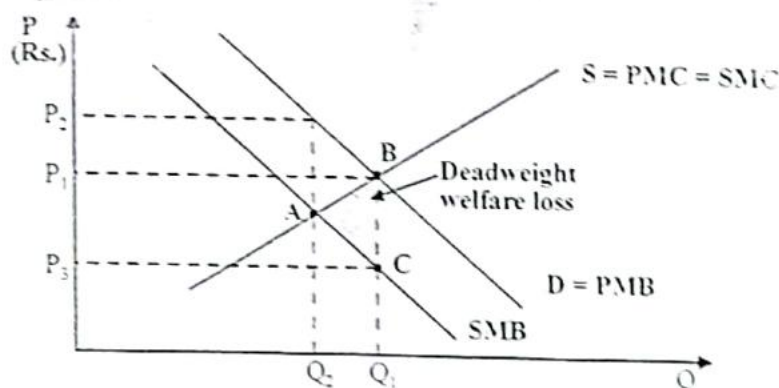
(b) - There are two types of tax incidence, they are legal incidence and economic incidence. The legal incidence of taxes falls on those who are legally required to submit tax payments to government. Legal incidence is established by law and tells us which individuals or companies must physically send tax payments to the state. The economic incidence of a tax is the final burden of that particular tax on the distribution of economic welfare in society. (02 marks)

- The difference between the economic incidence and legal incidence depends upon the shifting ability of a tax. For example, when a tax is impossible to shift, legal incidence and economic incidence become identical. (02 marks)

(Total marks 06)

(iv) - A negative externality in consumption occurs when consuming a good causes a harmful effect to a third party. For example, consuming loud music late at night keeps your neighbours awake. Similarly, consuming cigarettes causes passive smoking to others in the vicinity. In these cases, the social benefit is less than the private benefit. (02 marks)

- If goods or services have negative externalities in consumption, then we will see market failure. This is because individuals fail to take into account the costs to others. Free market quantity of production is greater than socially desirable level of production. Over-production results in an allocative inefficiency creating a dead-weight welfare loss. (02 marks)



- In a free market, we get Q_1 output. But at this output, the social marginal cost is greater than the social marginal benefit.

- ABC triangle is the area of dead-weight welfare loss
- Social efficiency occurs at a lower output (Q_2) - where social marginal benefit = social marginal cost.

(01 mark for the correct diagram with correct labeling; 01 mark for the identification of the area of deadweight loss) (Total marks 06)

08

- 8 (i) State **three** factors determining comparative advantage of a country. (03 marks)
- (ii) What are the main accounts and items in the Balance of Payments statement? (04 marks)
- (iii) Explain the difference between regional trading agreement and a bilateral trading agreement drawing examples from Sri Lanka. (06 marks)
- (iv) "The exports to Gross Domestic Product ratio which stood at 30% in the year 2000 almost halved to 14.8% by 2020." Explain the reasons for the dismal performance of the export sector of Sri Lanka in the recent decades. (07 marks)

3. (i) - The quantity and quality of natural resources available
- Demographics : (inward migration, educational improvements and women's participation in the labour force will all affect the quantity and quality of the labour force available for industries engaged in international trade.)
 - Rates of capital investment including infrastructure: (Greater public infrastructure investment can reduce trade costs and hence increasing supply capacity. Investment in roads, ports and other transport infrastructure strengthens regional trade ties.)
 - Increasing returns to scale and the division of labour
 - Investment in research & development (innovations)
 - Government policies: (taxes, subsidies, exchange rate)
 - Institutions: (Banking systems are needed to provide capital for investment and export credits, legal systems help to enforce contracts, political institutions and the stability of democracy is a key factor behind decisions about where international capital flows.
 - Location: (Climate and geography have key roles in creating differences in comparative advantage)
- Handwritten notes:* differences in taste, technological advances
- (01 mark each for any three factors; Total marks 03)
- (ii) - Current Account (01 mark)
- Goods
 - Services
 - Primary incomes
 - Secondary incomes
- (01 mark)
- Capital Account (01 mark)
 - Financial Account (01 mark)
 - Direct investment
 - Portfolio investment
 - Other investment
 - Reserve assets
- (01 mark for correct items under current account or financial account; Total marks 04))
- Handwritten note:* sub factors of any acc. - 01

- (iii) - A bilateral trade agreement confers favoured trading status between two nations. By giving them access to each other's markets, it increases trade and economic growth. The terms of the agreement standardize business operations and level the playing field. (02 marks)

- Examples:

Indo-Sri Lanka Free Trade Agreement
Sri Lanka - Pakistan Free Trade Agreement
Sri Lanka - Singapore Free Trade Agreement

(01 mark for the example)

- Regional trading agreements refer to a treaty that is signed by two or more countries in the region to encourage the free movement of goods and services across the borders of its members. The agreement comes with internal rules that member countries follow among themselves. (02 marks)

- Examples:

South Asian Free Trade Area (SAFTA),
Asia Pacific Trade Agreement (APTA)
The SAARC Preferential Trading Arrangement (SAPTA)

(01 mark for the example)

- (iv) - Very limited diversification of export products: Export composition has been rigidly stable since the mid-1990s. They have not diversified beyond a set of few traditional goods - garments, tea and rubber.

- Lack of diversification of export markets: Europe and USA continue to account for approximately two-thirds of total exports. Further, approximately 70% of tea exports are to the Middle East and Commonwealth of Independent Nations.

- Lack of investment in export-oriented industries. Export-oriented foreign direct investment (FDI) has played a key role in creating a dynamic, fast growing export sector in the Newly Industrialized Countries (NICs) in East Asia, but Sri Lanka has not been successful in tapping into this vein.

- Sri Lanka's exports are biased towards low-complexity products, implying low know-how. Sri Lanka's production system is based on simple technology, borrowed from Western nations when they moved from simple technology to complex technology. That level of technology can no longer support Sri Lanka's planned goal of creating an export hub supported by inventions and entrepreneurship.

- Current major export industries are being squeezed, with wage growth outpacing productivity gains.
- High cost and low productivity in tea export sector: Input costs and technology used (labour intensive) and low land productivity (older plantations have lower yield) imply higher cost of production in Sri Lanka compared to other tea producing nations.
- Declining labour force and increasing labour cost: Retaining labour in tea estates has become a challenge. This results from a combination of factors such as the low social status of the work, improved education among younger generation and other more dignified and lucrative employment opportunities outside of tea estates.
- Failure to utilize the opportunities for export expansion available under free trade agreements so far signed by Sri Lanka,

(02 marks each for any ⁴three reasons; Total marks 08)

7

69	
9. (i) Distinguish between economic development and human development.	(04 marks)
(ii) What is the difference between poverty line and poverty headcount index?	(04 marks)
(iii) Explain reasons why a substantial part of the working-age population might be economically inactive.	(04 marks)
(iv) (a) What is meant by social safety net?	(02 marks)
(b) Examine what are the shortcomings of social safety net programmes currently implemented in Sri Lanka.	(06 marks)

9. (i) - Economic development and human development are concepts that are related to one another in that they both measure a country's overall development in terms of economic wealth and human welfare. While human development is very much focused on the wellbeing of people, economic development covers a wide spectrum of social and economic factors.

- Human development is the process in which an individual's freedom, opportunities, and wellbeing are continuously improved. The concept of human development was developed in the 1970s on the premise that Gross Domestic Product or GDP (largely a measure of economic growth) failed to give justice to the measurement of human development.

- Human development is about providing more freedom and opportunity to the people for living their lives as they wish. For this, people should be able to improve and use their capabilities.

- The concept of human development believes that people should have good health, access to education, and a decent standard of living. Human development is measured by the Human Development Index (HDI). The HDI measures the education levels, health and standard of living. Other measures of human development include the Human Poverty Index (HPI) and Gender Empowerment Measure (GEM)

M P I - multi-dimensional Poverty Index

- Economic development is a wider concept and has qualitative dimensions. Economic development implies economic growth plus progressive changes in certain important variables which determine the well-being of the people. Economic development includes the development of human capital, improving standards of living, development of infrastructure, economic growth (as measured by GDP), increase in international trade, environmental health, improving health, public safety, social justice, life expectancy, literacy, etc.

(02 marks each for any two differences; Total marks 04)

) - Poverty line is the minimum amount of money required for a person to fulfill the basic necessities of life, like shelter and food per month.

- In Sri Lanka, the official poverty line is estimated on the Cost of Basic Needs Method (CBN). Food poverty line is calculated by an estimate of the cost of the food bundle, which satisfies a person's minimum caloric requirements. Then it is added a non-food component, which estimates the allowance for basic necessities such as housing, clothing, transport etc., (02 marks)

- People living below a poverty line don't have enough to meet their basic needs and they are called poor. Poverty Headcount Index is the percentage of the population living below the national poverty line. (02 marks)

(Total marks 04)

(iii) - Persons who are in the working-age population are not in the labour force for the following reasons:

- Full time care of the household
- Full-time students
- Retired or old age
- Long term sickness or disability
- Those who are not interested in working for one reason or another

(01 mark each for any four reasons; total marks 04)

(iv)(a) - The social safety net (SSN) refers to of non-contributory assistance existing to improve lives of vulnerable segments of the population: the poor, elderly, disabled, children and women. (01 mark)

- Social protection has been increasingly viewed as an important tool for addressing poverty, vulnerability, inequality, and social exclusion. These programmes vary from cash and in-kind transfers to pensions, insurance, and livelihood development programmes. (01 mark)

(b) Despite the multitude of programmes, there are several gaps and weaknesses in the current social protection system in Sri Lanka.

- Low coverage and poor targeting: Low coverage and poor targeting are two most common problems in the majority of social protection programmes in Sri Lanka. Programmes designed for the poor, elderly, disabled and other vulnerable groups often cover only a fragment of the eligible population.

- Targeting procedure of the Samurdhi programme has been influenced by local political patronage, particularly at the grassroots level as many of the field officers are political appointees. The selection of the beneficiaries of Samurdhi has been reported to be biased towards individuals of particular political affiliations. The primary abuse appears to be the inclusion of large numbers of ineligible households as a reward for political loyalty to the governing party.
- **Budgetary Constraints and Inequitable Resource Allocation:** Many social assistance programmes suffer from budgetary constraints, which restrict them from expanding their coverage and improving the benefit amounts.
- **Lack of coordination:** Currently, there are several ministries, departments, and provincial councils carrying out different social protection programmes for various vulnerable groups. Lack of coordination among these institutions and programmes increases the cost of social protection provision and leads to overlaps in beneficiaries served under these programmes.
- Despite being officially a development programme for economic integration, Samurdhi has been criticised by international actors such as the FAO as being an approach to welfare that promotes dependency rather than aiding the socioeconomic development of Sri Lankan citizens. The FAO sees it as a mechanism that makes the initiative difficult to sustain over time

(02 marks each for any three shortcomings ; Total marks 06)

→ No identification of the determinants of the programs.

- 1) What is meant by restructuring of public debt? (04 marks)
- 2) State the essential policy changes required for Sri Lanka to overcome the current economic crisis. (05 marks)
- 3) Describe the importance of Global Production Sharing Networks as a strategy for promoting export earnings in Sri Lanka. (05 marks)
- 4) Analyse the factors which have prevented Sri Lanka achieving a rapid economic growth since Independence? (06 marks)

- The Restructuring of public debt is the process undertaken to re-establish debt Sustainability. The decision to restructure is undertaken when no other option to re-gain debt sustainability is considered politically or socially acceptable. (01 mark)

- The Debt Restructuring aims at manageable levels of Gross Financing Needs (GFNs), manageable levels of debt services denominated in domestic and foreign currency and a declining debt to Gross Domestic Product (GDP) ratio to manageable levels in the medium-to-long run. *debt service payment* (01 mark)

- Accordingly, once the decision of debt restructuring is made the debtor is required to indicate on which claims should be included, i.e., subject to the restructuring, and which should be excluded.

- Once the decision on which claims should be included in the Debt Restructuring process, the following methods and types will be used for implementation.

- **Face Value Reduction** - A face value reduction is typically the most extreme adjustment, i.e. it provides the highest degree of relief to the Debtor. Also known as a 'haircut', the nominal value of outstanding debt is reduced.
- **Maturity Extension** - Maturity extensions, also known as 'reprofiling', are less extreme than haircuts; they involve maintaining the original nominal value of the liability but changing the date on which the final principal payment is to be repaid.
- **Coupon Adjustment** - Coupon adjustments provide some relief to the debtor but do not provide haircuts and do not change the final maturity date.

- Most restructurings will use a combination of all three types to achieve the desired level of relief in the context of what is acceptable to creditors. (02 marks)

(Total marks 04)

(ii) - Successful completion of the debt restructuring programme

- To address corruption and uphold the rule of law the government should
 - Commit to adopting robust anti-corruption measures
 - Enact procurement legislation requiring open bidding for government Contracts
 - Rejoin the Stolen Assets Recovery (StAR) initiative, a joint program of the World Bank and the United Nations Office on Drugs and Crime.

- Fiscal consolidation and strengthening revenue mobilisation
- Medium term expenditure framework and public sector reforms
- Adequately fund the public health and education systems
- State Owned Enterprise Reforms
- Strengthening the independence of the Central Bank and enhancing monetary policy effectiveness
- Maintaining Exchange Rate Flexibility
- Supporting trade and investment to strengthen external sustainability
- Take appropriate measures to improve the Sri Lanka's position in the Ease of Doing Business Index

(01 mark each for any five policy changes)

- Encouraging SME's by strengthening the production of domestic producers
- iii) - Global production sharing—the breakup of a production process into vertically separated stages that are carried out in different countries—has become one of the defining characteristics of world trade over the past few decades. Global production sharing opens up opportunities for firms to relocate slices (tasks) of the production process to different countries, depending on relative cost advantage and other economic fundamentals.

- Production sharing, on the other hand, involves producing and supplying different components of a single product. For instance, Toyota cars are manufactured in Japan; but the parts for same are supplied by a variety of suppliers who have manufacturing facilities in different countries.

(02 marks)

- A country that does not have factor inputs and technology required for the production of a good or service can now focus on a particular slice or segment of the production process that matches its capabilities. For production, the availability of domestic resources is no longer a binding constraint on international trade.

(02 marks)

- To date, most of the Sri Lanka's FDI is in Buyer driven GPNs where a buyer (usually a retailer) buys finished goods. Although common in industries such as garments and footwear, globally buyer driven GPN's formed only 12 per cent of world manufacturing trade, and its share is declining.
- Producer driven GPNs are where an end producer assembles the final product from components made in several locations. Producer driven GPN's accounted for 51.1 per cent of world manufacturing and its share is growing. This is the trend Sri Lanka needs to tap into. Sri Lanka does not have a choice except joining the global production networks. Otherwise, Sri Lanka will remain eternally a middle-income country.

(01 mark)

(Total marks 05)



(iv) - The pre-conditions for long-run sustained economic and social development have been conspicuously absent in our country. They include national unity, political stability, the rule of law, eradication of corruption, pragmatic economic policies and their effective implementation. The absence of these non-economic preconditions was largely responsible for the country's below potential economic performance.

- A stable government committed to the long-run development of the country and ensuring the rule of law, achievement of ethnic religious and social harmony, eradication of corruption, sound and pragmatic economic policies and certainty in their continuity and effective implementation has only been a dream over the last few decades. The political culture and milieu and ambitions of politicians and vested and parochial interests have not supported needed political and economic reforms. (02 marks)

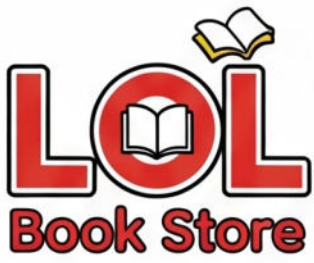
- Populist policies followed by all mainstream political parties have made our people become more dependent on the government. The unique selling point of a political party's economic policies have been the size of the relief package, number of government jobs, and glittery promises which are beyond delivery under any realistic situation. Further, the political culture and milieu and ambitions of politicians and vested and parochial interests have not supported needed political and economic reforms. (02 marks)

- Number of other reasons too that influence economic development such as a people's values, work ethic, education and the political culture and milieu. Weak work ethics and indiscipline, particularly in the state sector, are important reasons for the country's lower economic development.

- Ideological rather than pragmatic policies, inability to seize the opportunities to export in a liberalised international economy and neglect of and underdevelopment of technical skills are among the many reasons for the country's economic underperformance. (02 marks)

→ No home-grown economic policies are not implemented. (Total marks 06)

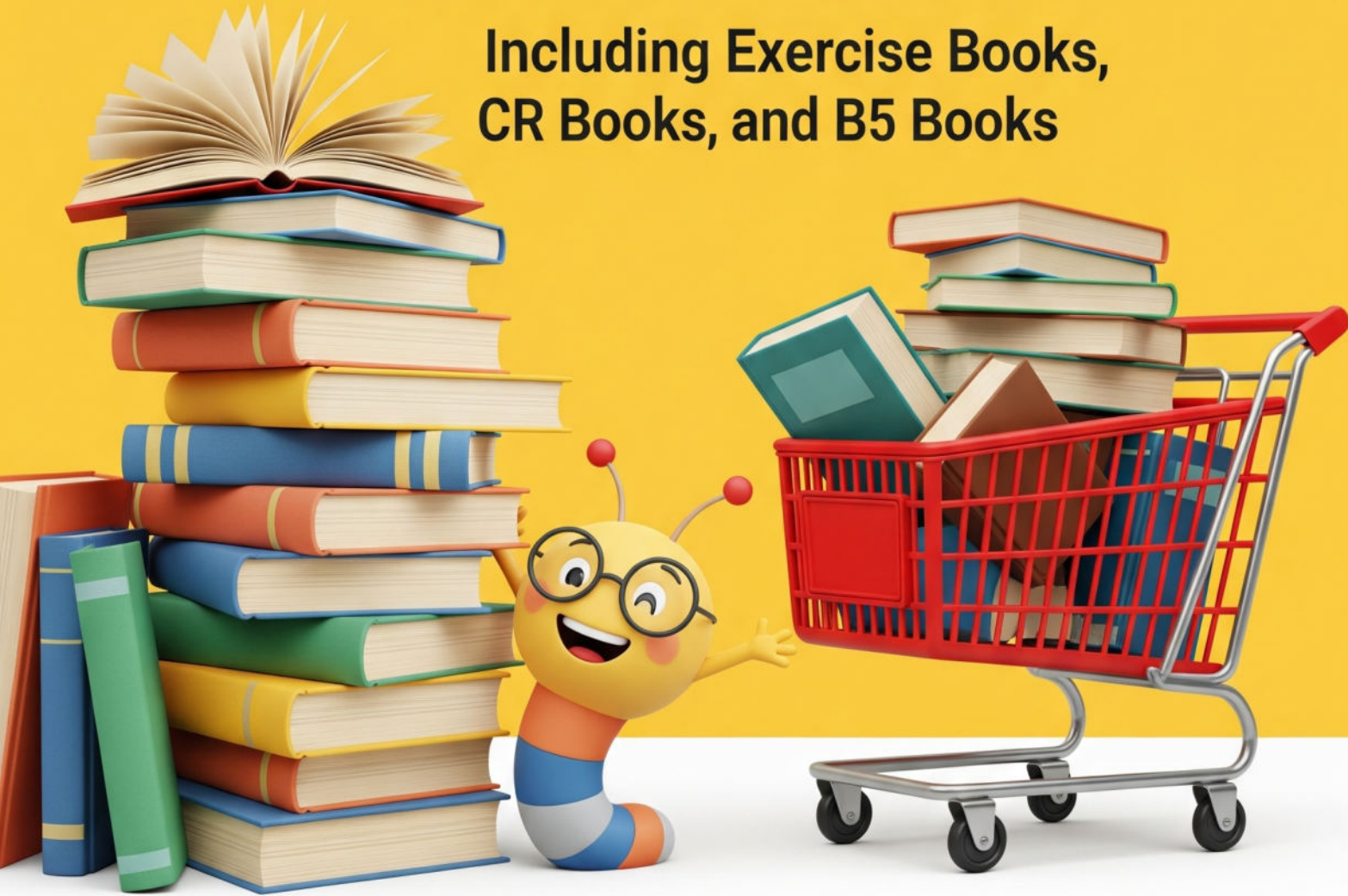
→ No sustainable policies to encourage foreign investments and taking more foreign loans.



වාර්තාවක් ලෙස කරන පොත් චිකිත්සා
මිලදී ගැනීම සඳහා දැන් ගෙවරටම ගෙන්වා ගන්න

25% OFF ALL BOOKS

Including Exercise Books,
CR Books, and B5 Books



මිනිම අභ්‍යාස පොතකට 25%ක විශේෂ වට්ටමක්

ORDER BOOKS FROM **LOL BOOKS STORE**



0372060110 WWW.LOL.LK



071 777 4440 (WhatsApp)

Cash On Delivery Available

ORDER A/L $a+b^2$ TERM TEST PAPERS, SHORT NOTES, WORKBOOKS & REVISION BOOKS

SINHALA, ENGLISH & TAMIL MEDIUM



LOL BOOK STORE

CASH ON DELIVERY AND KOKO PAYMENT AVAILABLE

0717774440 (WHATSAPP)

WWW.LOL.LK