



De Mazenod College – Kandana
G.C.E. (A/L) Examination 2016
Preparation Test (February 2016)
Economics I (E-21)



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	Signature	Code No.
1st Examiner		
2nd Examiner		
Addl. Chief		
E.M.F.		
Chief		

Instructions:

- * Answer all the questions on this question paper itself.
- * Write your **Index Number** in the space provided in the answer sheet.
- * Select the correct answers for questions No. 1-50 and write its number on the dotted line given.

1. Which of the following is a microeconomic statement?
 - (1) The price of rubber declined by 10% last year.
 - (2) Unemployment was 5.8% of the labour force last year.
 - (3) The real Gross Domestic Product increased by 7% last year.
 - (4) The general price level increased by 4% last year.
 - (5) The tax revenue of the government decreased by 8% last year. (.....)

2. The three key groups of decision makers in an economic system are
 - (1) households, business firms and banks.
 - (2) households, business firms and government.
 - (3) business firms, government and non-governmental organizations.
 - (4) business firms, banks and foreign traders.
 - (5) households, government and banks. (.....)

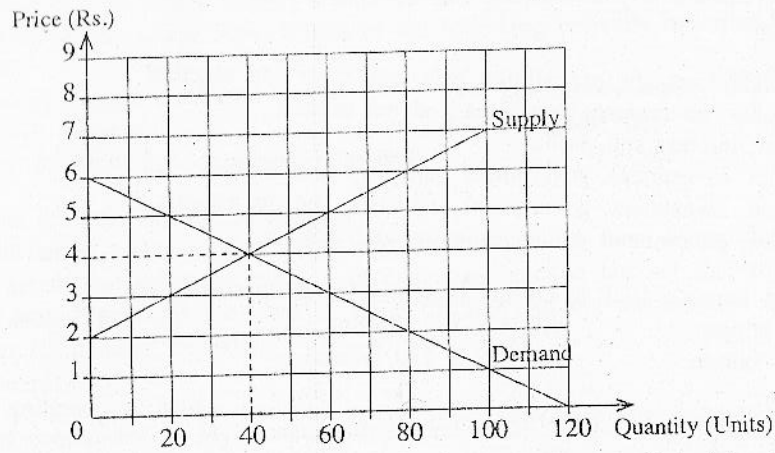
3. The opportunity cost of a particular activity
 - (1) is the same for everyone pursuing the activity.
 - (2) includes both monetary costs and foregone income.
 - (3) includes monetary cost only.
 - (4) includes foregone income only.
 - (5) measures the direct benefits of that activity. (.....)

4. Along a country's production possibilities frontier,
 - (1) the level of technology is changing.
 - (2) more of one good can be produced without giving up producing some of the other good.
 - (3) resources are not being fully utilized.
 - (4) available resources are being fully utilized.
 - (5) there is productive inefficiency in the economy. (.....)

5. If resources were perfectly substitutable in all economic activities, which of the following would be true?
 - (1) Output of all goods could be increased.
 - (2) The production possibilities curve would be a straight line.
 - (3) Specialization and mutually beneficial trade would be impossible.
 - (4) No country or individual would have a comparative advantage in any activity.
 - (5) Scarcity of resources would be eliminated. (.....)

6. The economy based on capitalism includes all of the following characteristics **except**
- (1) a price system based on demand and supply.
 - (2) a system of private property.
 - (3) self interest among households and entrepreneurs.
 - (4) freedom of enterprise.
 - (5) centralized planning. (.....)
7. The degree of government involvement in the economy is **greater** in
- (1) a market economy. (2) a command economy. (3) a mixed economy.
 - (4) a social market economy. (5) a traditional economy. (.....)
8. If the demand for milk powder increases whenever a person's income increases, then milk powder is an example of
- (1) an inferior good. (2) a free good. (3) a Giffen good.
 - (4) a public good. (5) a normal good. (.....)
9. At a given time, when demand increases and supply decreases in a competitive market for a 'normal good',
- (1) equilibrium price will fall and equilibrium quantity will rise.
 - (2) equilibrium price and quantity will both rise.
 - (3) equilibrium quantity will rise; equilibrium price will either rise or fall.
 - (4) equilibrium price will fall; equilibrium quantity will either rise or fall.
 - (5) equilibrium price will rise; equilibrium quantity will either rise, fall or remain unchanged. (.....)
10. Sugar and jaggery are considered as substitutes for each other in many consumption activities. Therefore, if the price of sugar rises, we would expect
- (1) the demand for jaggery to increase.
 - (2) the demand for jaggery to decrease.
 - (3) the quantity demanded for jaggery to decrease.
 - (4) the price of jaggery to decrease.
 - (5) the quantity demanded for jaggery to increase. (.....)
11. Suppose that the price elasticity of demand for coconut is -1.0 . When the price is Rs. 60 per coconut, quantity demand is 500 coconuts. What will be the price of coconut when the quantity demand is 600 coconuts?
- (1) Rs. 30 (2) Rs. 40 (3) Rs. 50 (4) Rs. 55 (5) Rs. 60 (.....)
12. Which of the following will cause the demand curve for a good to shift to the left?
- (1) An increase in the price of the good
 - (2) A decrease in the price of the good
 - (3) A decrease in the price of a complementary good
 - (4) An increase in the price of a substitute good
 - (5) An expectation of a future price decline (.....)
13. With a downward sloping market demand curve and an upward sloping market supply curve for a product, a decrease in input price will:
- (1) increase equilibrium price and quantity.
 - (2) decrease equilibrium price and quantity.
 - (3) shift the supply curve to the left.
 - (4) decrease equilibrium price and increase equilibrium quantity.
 - (5) increase equilibrium price and decrease equilibrium quantity. (.....)
14. A small country's domestic market demand curve and supply curve for sugar are respectively represented by the following equations:
- $$Q_d = 320 - 3P \text{ (Demand)}$$
- $$Q_s = -80 + 2P \text{ (Supply)}$$
- Assume that the sugar market is open to international trade and the world market price of sugar is Rs. 60 per unit. What is the quantity of sugar that are domestically supplied when the country is open to international trade?
- (1) 40 units (2) 60 units (3) 80 units (4) 100 units (5) 140 units (.....)
15. Suppose the demand for petrol is very inelastic and the supply is very elastic. An excise tax on petrol will be borne
- (1) more heavily by buyers. (2) more heavily by sellers.
 - (3) equally by buyers and sellers. (4) entirely by taxpayers.
 - (5) by neither buyers nor sellers. (.....)

16. The graph shows the demand and supply curves in a competitive market for an agricultural commodity.



The government wants to promote the production of this commodity and decides to pay producers a subsidy of Rs. 2 per unit that they produce. The consumers' surplus after the subsidy is,
 (1) Rs. 20. (2) Rs. 80. (3) Rs. 90. (4) Rs. 160. (5) Rs. 180. (.....)

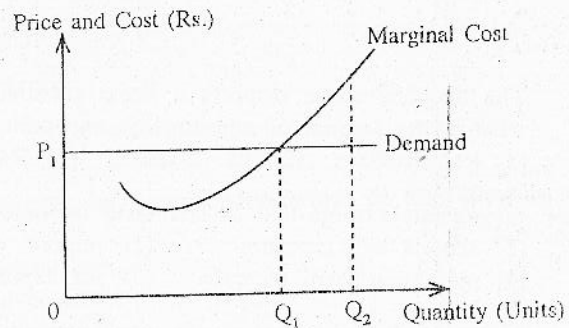
17. A price ceiling set below the market equilibrium price will result in
 (1) an excess supply. (2) an excess demand. (3) an equilibrium price.
 (4) an increase in supply. (5) a decrease in demand. (.....)

18. In the production process, a short run is a period of time in which
 (1) the firm is not able to hire more workers. (2) the amount of output produced is fixed.
 (3) there is a shortage of most inputs. (4) all inputs are fixed but output can be varied.
 (5) the quantities of some inputs are fixed and others can be varied. (.....)

19. The vertical distance between the total cost (TC) and total variable cost (TVC) curves is
 (1) decreasing as output decreases. (2) increasing as output decreases.
 (3) equal to marginal cost (MC). (4) equal to total fixed cost (TFC).
 (5) equal to average fixed cost (AFC). (.....)

20. Given the cost and demand schedules of a competitive firm depicted in the diagram given below, if the firm increased output from Q_1 to Q_2 , it would

- (1) earn a normal profit.
- (2) experience an increase in profit.
- (3) experience a decline in profits.
- (4) increase revenues but not costs.
- (5) increase costs but no revenues.



21. Which of the following is **not** a characteristic of monopolistically competitive market?
 (1) Relatively easy market entry (2) Differentiated products
 (3) Substantial product advertising (4) A large number of both buyers and sellers
 (5) Firms face perfectly elastic demand curves (.....)

22. In the circular flow of income diagram of an economy, which one of the following flows directly from government?
 (1) Taxes (T) (2) Exports (X) (3) Savings (S)
 (4) Transfer payments (Tr.) (5) Investment expenditure (I) (.....)

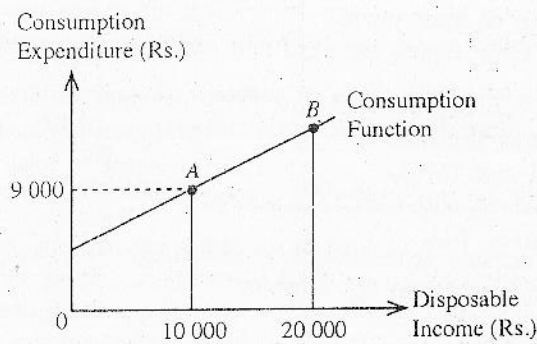
23. In the contractionary phase of the business cycle,
 (1) investment is rising and the output is falling.
 (2) unemployment is rising and the output is falling.
 (3) unemployment is falling and the price level is rising.
 (4) unemployment is falling and the output is rising.
 (5) unemployment is rising and the output is rising. (.....)

24. At present, the largest component of gross domestic capital formation in Sri Lanka is
 (1) machinery and equipment. (2) financial assets.
 (3) land improvement and plantation development. (4) changes in stocks.
 (5) construction. (.....)
25. To calculate GDP from the expenditure side, one must add together
 (1) wages, profits, government purchases and net exports.
 (2) wages, rent, interest and profits.
 (3) consumption, investment, government purchases and exports.
 (4) consumption, investment, government purchases and net exports. (.....)
 (5) consumption, government purchases, taxes and interest.
26. At present, Sri Lanka's GDP at current market price is approximately
 (1) US \$ 50 billion. (2) US \$ 75 billion. (3) US \$ 100 billion.
 (4) US \$ 125 billion. (5) US \$ 150 billion. (.....)
27. Consider the following macroeconomic data for an economy which is operating at an equilibrium national income level.

Item	Rs. million	Item	Rs. million
Consumption expenditure	5 000	Imports	1 200
Tax revenue	1 000	Exports	980
Government purchases	1 500	GDP at market price	8 000

The level of investment in this economy is

- (1) Rs. 310 million. (2) Rs. 320 million. (3) Rs. 1 220 million.
 (4) Rs. 1 720 million. (5) Rs. 1 940 million. (.....)
- 28.



- The diagram above displays a linear consumption function. If the autonomous consumption is Rs. 4 000, what is the amount of consumption expenditure does point B correspond to?
 (1) Rs. 18 000 (2) Rs. 17 000 (3) Rs. 16 000 (4) Rs. 14 000 (5) Rs. 10 000 (.....)
29. Economists assume that as real GDP increases
 (1) exports will increase. (2) imports will decrease. (3) net exports will be constant.
 (4) net exports will increase. (5) net exports will decrease. (.....)
30. Which of the following groups would actually benefit from an occurrence of unexpectedly high inflationary price increase?
 (1) Retired workers
 (2) Lenders
 (3) Wage earners
 (4) Elderly people who have saved money during their working years
 (5) Borrowers (.....)
31. When an economy is at full employment, which of the following will most likely to generate demand-pull inflation?
 (1) A decrease in the budget deficit (2) A decrease in net exports
 (3) A decrease in trade union power (4) A decrease in the real rate of interest
 (5) A decrease in the money supply (.....)

32. Over a period of one year a country's inflation rate was 12%. Over the same period the growth of nominal Gross National Product was 14%. Which of the following correctly describes what happened during the one year period?
- (1) The money supply decreases by 2% (2) The money supply increased by 2%
 (3) Real GNP increased (4) Real GNP fell
 (5) Velocity of circulation of money increased (.....)
33. The concept of 'near money' refers to
- (1) financial assets whose capital values are too unstable for them to be classified as money.
 (2) liquid assets that fulfil the medium of exchange function but not the store of value function.
 (3) liquid assets that fulfil the store of value function but not the medium of exchange function.
 (4) cheques on demand deposits.
 (5) credit cards. (.....)
34. The largest component of M_4 monetary aggregate in Sri Lanka at present is
- (1) currency held by the public.
 (2) demand deposits held by the public.
 (3) quasi money held by the public with Licensed Finance Companies.
 (4) quasi money held by the public with commercial banks.
 (5) quasi money held by the public with Licensed Specialized Banks. (.....)
35. Suppose that in a commercial banking system, all banks maintain 20% of deposits as a cash reserve. One bank receives a new cash deposit of Rs. 200 million. If there is no subsequent change in currency in circulation, what will be the maximum amount of loans that the banking system can grant as a result of the new deposit?
- (1) Rs. 160 million. (2) Rs. 200 million. (3) Rs. 800 million.
 (4) Rs. 1000 million. (5) Rs. 1200 million. (.....)
36. Which one of the following would be expected to occur as the result of an open market sale of government securities by the Central Bank?
- (1) Increase in real GDP. (2) Increase in interest rates charged on loans.
 (3) Increase in number of loans made by banks. (4) Increase in private investment spending.
 (5) Increase in the money supply. (.....)
37. Which of the following does not indicate market failure?
- (1) Existence of monopolies.
 (2) Excessive air and water pollution.
 (3) A lack of such necessities as national defence.
 (4) The adequate supply of public goods.
 (5) An unequal distribution of income. (.....)
38. If an industry ignores the external costs it generates in its production, which of the following will be true at the competitive market equilibrium output?
- (1) Price will be greater than the marginal social cost.
 (2) Price will be less than the marginal social cost.
 (3) Price will be equal to the marginal social cost.
 (4) Marginal private cost will be equal to the marginal social cost.
 (5) Marginal private cost will be greater than the marginal social cost. (.....)
39. A pure public good is a good that is.
- (1) provided efficiently by markets. (2) rivalrous and excludable in consumption.
 (3) nonrivalrous and excludable in consumption. (4) rivalrous and nonexcludable in consumption.
 (5) nonrivalrous and nonexcludable in consumption. (.....)
40. Fiscal policy involves the government determining
- (1) market interest rates. (2) the money supply growth rate.
 (3) taxation and government spending levels. (4) the money supply.
 (5) the rate of inflation. (.....)
41. At present, the single largest tax revenue source of the government of Sri Lanka is
- (1) Value added tax. (2) Corporate income tax. (3) Excise tax.
 (4) Import duty. (5) Pay-As-You-Earn (PAYE) tax. (.....)
42. The major determinants of comparative advantage among countries include all of the following except
- (1) per capita income. (2) climate. (3) labour force skills.
 (4) capital per worker. (5) geographical location. (.....)

43. The table below shows the number of bicycles and tractors which can be produced with a composite resource unit in country A and country B.

Product	Country A	Country B
Tractors	20	2
Bicycles	60	10

Assume that each country specializes in the production in which it has a comparative advantage. For mutually beneficial trade to occur, the rate of exchange between tractors and bicycles should be

- (1) less than 3 bicycles per tractor. (2) between 3 and 5 bicycles per tractor.
 (3) between 2 and 60 bicycles per tractor. (4) between 6 and 10 bicycles per tractor.
 (5) more than 10 bicycles per tractor. (.....)

44. Which is the only combination of price changes that must result in a deterioration in a country's terms of trade?

	Average price of exports	Average price of imports
(1)	falls	rises
(2)	falls	falls
(3)	rises	falls
(4)	rises	rises
(5)	remains unchanged	falls

(.....)

45. Under a flexible exchange rate system, which of the following should increase the rupee price of the US dollar?

- (1) The rate of inflation greater in the United States than in Sri Lanka
 (2) National income increases greater in the United States than in Sri Lanka
 (3) The increased preference of US citizens for Sri Lankan garments
 (4) A substantial reduction of imports coming to Sri Lanka from the United States
 (5) Real interest rate increases greater in the United States than in Sri Lanka (.....)

46. Economic growth is usually measured by the annual percentage change in

- (1) nominal GDP. (2) real GDP.
 (3) nominal GDP per capita. (4) per capita disposable national income.
 (5) purchasing power parity GDP per capita. (.....)

47. In a hypothetical economy, if the number of people classified as unemployed is 50 000 and the number of people classified as employed is 450 000, then the rate of unemployment in that economy is

- (1) 11.1% (2) 10.0% (3) 9.2% (4) 8.0% (5) 7.4% (.....)

48. Public goods are not provided by the market system because,

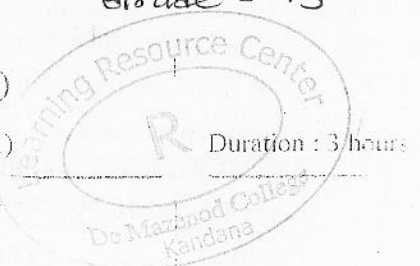
- (1) even if a cost is incurred in consumption, a profit cannot be earned.
 (2) a price cannot be charged and non-rivalry in consumption.
 (3) those who do not pay a price cannot be excluded and non-rivalry in consumption.
 (4) even if a profit can be earned, a cost is incurred in consumption.
 (5) even if a price can be charged, it cannot be easily implemented. (.....)

49. Social benefits are higher than the private benefits in

- (1) education and health services.
 (2) infrastructure and environmental conservation activities.
 (3) ports and airport services.
 (4) roads and hospital services.
 (5) national parks and environmental conservation activities. (.....)

50. The supply-side policy measures that promote production are,

- (1) production subsidies, deregulation, tax reforms and nationalization.
 (2) tax reforms, nationalization, deregulation, removal of rigidities in labour and capital markets.
 (3) regulation, tax reforms, expansion of administrative and development activities and labour and capital market reforms.
 (4) production subsidies, expansion of administrative and development activities, deregulation and trade restrictions.
 (5) tax reforms, privatization, deregulation and labour and capital market reforms. (.....)



Sub-section A

(Select minimum of two questions from this Section.)

1. (i) What is the difference between 'capital' and 'human capital'? (04 marks)
- (ii) In what ways does money facilitate specialization and the division of labour. (04 marks)
- (iii) Contrast how a market economy and a command economy try to cope with the problem of scarcity. (04 marks)

2. (i) What factors are held constant in drawing a market supply curve? (04 marks)
- (ii) Describe how the income and substitution effects explain the 'law of demand'. (04 marks)
- (iii) Distinguish between a price floor and a price ceiling and give an example of each. (04 marks)
- (iv) Who pays most of the burden of a specific (unit) tax on producers when supply is inelastic? Explain your answer using an appropriate diagram. (04 marks)
- (v) The following equations describe the market demand and supply functions of a commodity:

$$Q_d = 100 - 4P \text{ (Demand)} \quad Q_s = -30 + 6P \text{ (Supply)}$$
 - (a) Calculate the equilibrium price and quantity using the equations and show this equilibrium accurately on a graph. (02 marks)
 - (b) Calculate producer surplus and consumer surplus at market equilibrium and show them on a graph. (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 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)

5. (i) What are the three approaches in measuring aggregate economic activity of a country? Why do these three approaches give the same value for aggregate economic activity? (04 marks)
- (ii) What are the main sources of national savings in Sri Lanka? (04 marks)
- (iii) In what ways are national income statistics useful? (04 marks)
- (iv) Suppose you are given the following information about a hypothetical economy: (All figures are in Rs. million)

Item	Value	Item	Value
Gross private domestic investment	70	Government transfers to households	25
Government purchases	50	Interest payments from the government to households	15
Gross Domestic Product at market prices	400	Factor income received from abroad	7
Current account balance of the Balance of Payments	-25	Factor payments made to abroad	12
Taxes	100	Net foreign current transfers	10

Calculate the following, using the above information:

- (a) Net exports (02 marks)
- (b) Private consumption expenditure (02 marks)
- (c) Disposable Gross National Income (02 marks)
- (d) Government savings (02 marks)

Sub section 'B'

(Select minimum of two questions from this section.)

6. (i) Define 'money' and briefly describe how money has removed the defects of the barter system. (04 marks)
- (ii) Explain why credit cards are not money. (02 marks)
- (iii) List the macroeconomic variables that determine the demand for money in the economy. Briefly explain how these variables affect the demand for money. (04 marks)
- (iv) How would you distinguish between demand-pull inflation and cost-push inflation? Explain your answer using necessary diagrams. (04 marks)
- (v) Why there is very high level of excess liquidity in the domestic money market in Sri Lanka at present? What measures have been taken by the Central Bank of Sri Lanka to absorb the excess liquidity of the banking system? (06 marks)
7. (i) Define and give an example for each of the following categories of goods and services:
- (a) Global public goods
- (b) Common resources
- (c) Quasi public goods (06 marks)
- (ii) Distinguish between statutory tax incidence and economic tax incidence. (04 marks)
- (iii) What is meant by 'neutrality of taxation'? (02 marks)
- (iv) Distinguish between 'primary deficit' and 'net cash deficit' of the budget. (04 marks)
- (v) Identify the major non-tax revenue sources of the government of Sri Lanka. (04 marks)

08. (i) what is the task of the government in an economy? (4 marks)
- (ii) what are the steps that can be taken by a government to generate equity in the economy (4 marks)
- (iii) what is meant by 'market failure'? in what instances does market failure take place? (4 marks)
- (iv) explain the difference between 'private cost' and 'social cost' (4 marks)
- (v) explain with the use of a suitable diagram, the difference between the socially desirable output and the market output when there are negative externalities in production (4 marks)

09. i) explain the difference between 'theory of absolute advantage' and the 'theory of comparative advantage'? (4 marks)
- (ii) what factors would affect to exist the comparative advantages? (4 marks)
- (iii) what are the benefits that can be gained by a country by engaging in international trade activities? (4 marks)
- (iv) the following table shows some data of international trade activities

output per labour hour

country \ commodity	Israel	Russia
aero planes	0.2	0.4
missiles	0.8	0.6

- a) what are the countries that receive absolute advantage for the two products? (2 marks)
- b) find the opportunity cost of each country for each product separately (2 marks)
- c) find the countries which receive comparative advantage for the two products (2 marks)
- d) what product should Israel and Russia specialize? (2 marks)
10. (i) what is meant by economic growth? (4 marks)
- (ii) how does the government intervene for economic growth? (4 marks)
- (iii) what is the sectoral contribution of Gross Domestic Product of Sri Lanka? (5 marks)
- (iv) what are the main economic activities included in the service sector when assessing the Gross Domestic Product of Sri Lanka? (7 marks)