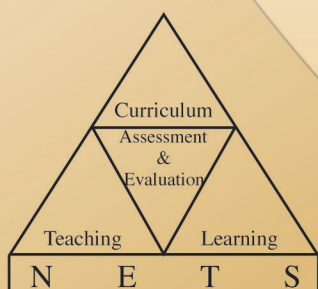




G.C.E.(A.L.) Examination - 2013

Evaluation Report

21 - Economics

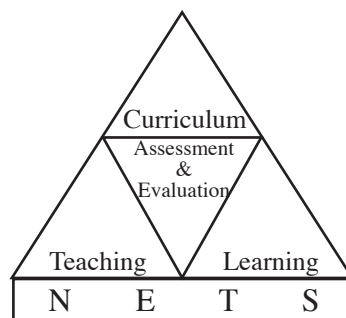


**Research & Development Branch
National Evaluation & Testing Service
Department of Examinations**

G.C.E. (A.L.) Examination - 2013

Evaluation Report

21 - Economics



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Economics

Evaluation Report - G.C.E.(O.L.) Examination - 2013

Financial Aid

**Transforming the School Education System as the
Foundation of a Knowledge Hub Project (TSEP-WB)**

INTRODUCTION

The General Certificate of Education (Advanced Level) Examination is the final certification examination of the Senior Secondary Education in Sri Lanka. Though certification of the students' achievement level at the end of Senior Secondary Education is the major aim of this examination, it bears a momentous position as an achievement test as well as a selection test because the eligible candidates for national universities and other higher education and vocational training institutes and also for the National Colleges of Education are selected on the results of this examination. This has also been accepted as an examination that certifies entry qualifications for the tertiary level employments. In the year 2013, 209906 school candidates and 31723 private candidates sat this examination.

Much pains are being taken by students to have a high achievement level at this examination and teachers and parents to fulfil their expectations. This evaluation report has been prepared by the Department of Examinations to assist the realization of their goals. It is certain that the information provided by this evaluation report is equally important for candidates, teachers, principals, in-service advisers, subject directors, parents and researchers in education. So it is appropriate to tender this report for wider reference.

This evaluation report comprises of three parts. I, II and III. Part I of this report consists of information related to aims and achievement of the subject Economics in G.C.E. (A.L) Examination. This report Presents the statistical information on subject achievement, this number of candidates sat for the subject, how they have obtained grades, how school candidates have obtained grades by district and distribution of marks according to class intervals and comprehensive analysis of the subject achievement which reveals how candidates have selected questions in Papers I and II in Econoomics and how they have scored marks for the questions from sub parts of each question. Part II of this report presents the questions in Paper I and Paper II of Economics in the G.C.E. (A.L) Examination 2013 and information about the candidates' responses to them. It encompasses expected answers for the questions of papers I and II, the scheme of marking, observations on answers, conclusions and constructive suggestions.

This evaluation report prepared by the Research and Development Branch of the Department of Examinations is based on the information, observations, ideas and suggestions provided by chief examiners, additional chief examiners and assistant examiners involved in evaluating answer scripts and the information drawn through the analysis of candidates' responses using the Classical Test Theory and the Item Response Theory.

Part III of this report embodies the facts that should be taken into consideration by the candidates when answering each question and opinions and suggestions with regard to the learning teaching process. I think that this report is of immense value in the organization of the learning teaching process to achieve respective competencies and competency levels. You are kindly requested to direct your productive ideas and suggestions to us to improve the quality of our future evaluation reports.

I wish to extend my sincere thanks to the chief examiners, additional chief examiners and assistant examiners who provided information to prepare this report, the committee members who fervently and actively contributed to the task, the officers and the staff of the Department of Examinations who shouldered the responsibility and the TSEP-WB that provided financial assistance for it.

W.M.N.J. Pushpakumara
Commissioner General of Examinations

19th December 2013
Research & Development Branch
Department of Examinations.
Pelawatta,
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Part I

1. Subject objectives and information on subject achievements

1.1 Subject objectives

- ★ To analyze basic economic problems in a society in a scientific manner and provide a critical understanding over the methods that could be used to resolve them .
- ★ To provide the skills essential for the analysis of economic approaches and problems with the help of theories and concepts of economic.
- ★ To provide an understanding over the behaviour of macro economic variables and its inter-relationships among them.
- ★ Persuade the students to investigate the rational behavior of the individuals and firms in a market
- ★ To develop the knowledge to think in the subject mathes of economics rationality and suchficality.
- ★ To create opportunities to study the established definitions with regard to diverse Scienhfic and economic concepts.
- ★ To analyze the way how a government intervenes to achieve macro economic goals through a market system.
- ★ To enable to critically analyze the existing economic policies.
- ★ To provide the skill required to critically analyze the diverse aspects of economic development in a balanced perspective.
- ★ To provide the basic competencies required for the explanation of economics in an analytical manner.
- ★ To highlight the importance of the international trade and finance and its relationship with globalization.
- ★ To develop skills which enable the students to critically observe the economic performance record of the Sri Lankan economy.
- ★ To lay foundation to the students for active participation for the social wellbeing.
- ★ To set the suitable stage to direct the students for higher education.

1.2 Statistical information on subject achievement

1.2.1 Number of candidates sat for the subject

Medium	School	Private	Total
Sinhala	62886	5150	68036
Tamil	9834	862	10696
English	1947	561	2508
Total	74667	6573	81240

Table 1

1.2.2 Grades obtained by the candidates

Grade	School Candidates		Private Candidates		Total	Percentage
	Number	Percentage	Number	Percentage		
A	4062	5.44	184	2.80	4246	5.23
B	6973	9.34	505	7.68	7478	9.20
C	16889	22.62	1319	20.06	18208	22.41
S	21715	29.08	1770	26.93	23485	28.91
F	25028	33.52	2795	42.52	27823	34.25
Total	74667	100.00	6573	100.00	81240	100.00

Table 2

1.2.3 Grades obtained by school candidates who sat the examination for the first attempt District wise

District	No. Sat	Distinction (A)		Very Good Pass (B)		Credit Pass (C)		Ordinary Pass (S)		Pass (A+B+C+S)		Fail (F)	
		Number	%	Number	%	Number	%	Number	%	Number	%	Number	%
1. Colombo	10663	902	8.46	1070	10.03	2375	22.27	3109	29.16	7456	69.92	2307	30.08
2. Gampaha	6794	420	6.18	579	8.52	1297	19.09	1905	28.04	4201	61.83	2593	38.17
3. Kalutara	3426	213	6.22	337	9.84	749	21.86	921	26.88	2220	64.80	1206	35.20
4. Kandy	4320	238	5.51	337	7.80	918	21.25	1230	28.47	2723	63.03	1597	36.97
5. Matale	1217	30	2.47	67	5.51	205	16.84	378	31.06	680	55.88	537	44.12
6. Nuwara Eliya	1711	79	4.62	134	7.83	372	21.74	442	25.83	1027	60.02	684	39.98
7. Galle	3295	239	7.25	306	9.29	652	19.79	882	26.77	2079	63.10	1216	36.90
8. Matara	2682	88	3.28	178	6.64	524	19.54	760	28.34	1550	57.79	1132	42.21
9. Hambantota	1629	45	2.76	130	7.98	318	19.52	457	28.05	950	58.32	679	41.68
10. Jaffna	1283	69	5.38	115	8.96	323	25.18	377	29.38	884	68.90	399	31.10
11. Kilinochchi	266	4	1.50	11	4.14	74	27.82	92	34.59	181	68.05	85	31.95
12. Mannar	234	16	6.84	20	8.55	56	23.93	61	26.07	153	65.38	81	34.62
13. Vavuniya	332	31	9.34	44	13.25	82	24.70	91	27.41	248	74.70	84	25.30
14. Mullativu	211	4	1.90	14	6.64	41	19.43	72	34.12	131	62.09	80	37.91
15. Batticaloa	954	50	5.24	116	12.16	245	25.68	275	28.83	686	71.91	268	28.09
16. Ampara	1570	54	3.44	129	8.22	348	22.17	523	33.31	1054	67.13	516	32.87
17. Trincomalee	829	39	4.70	58	7.00	157	18.94	260	31.36	514	62.00	315	38.00
18. Kurunegala	4464	173	3.88	295	6.61	915	20.50	1249	27.98	2632	58.96	1832	41.04
19. Puttalam	1833	77	4.20	167	9.11	422	23.02	529	28.86	1195	65.19	638	34.81
20. Anuradhapura	2257	71	3.15	154	6.82	374	16.57	660	29.24	1259	55.78	998	44.22
21. Polonnaruwa	1139	41	3.60	79	6.94	208	18.26	294	25.81	622	54.61	517	45.39
22. Badulla	2301	67	2.91	149	6.48	455	19.77	680	29.55	1351	58.71	950	41.29
23. Monaragala	1148	48	4.18	81	7.06	242	21.08	355	30.92	726	63.24	422	36.76
24. Ratnapura	2889	178	6.16	259	8.97	606	20.98	769	26.62	1812	62.72	1077	37.28
25. Kegalle	2025	63	3.11	144	7.11	400	19.75	587	28.99	1194	58.96	831	41.01
All Island	59472	3239	5.45	4973	8.36	12358	20.78	16958	28.51	37528	63.10	21044	35.38

Table 3

1.2.4 Marks obtained according to the class intervals

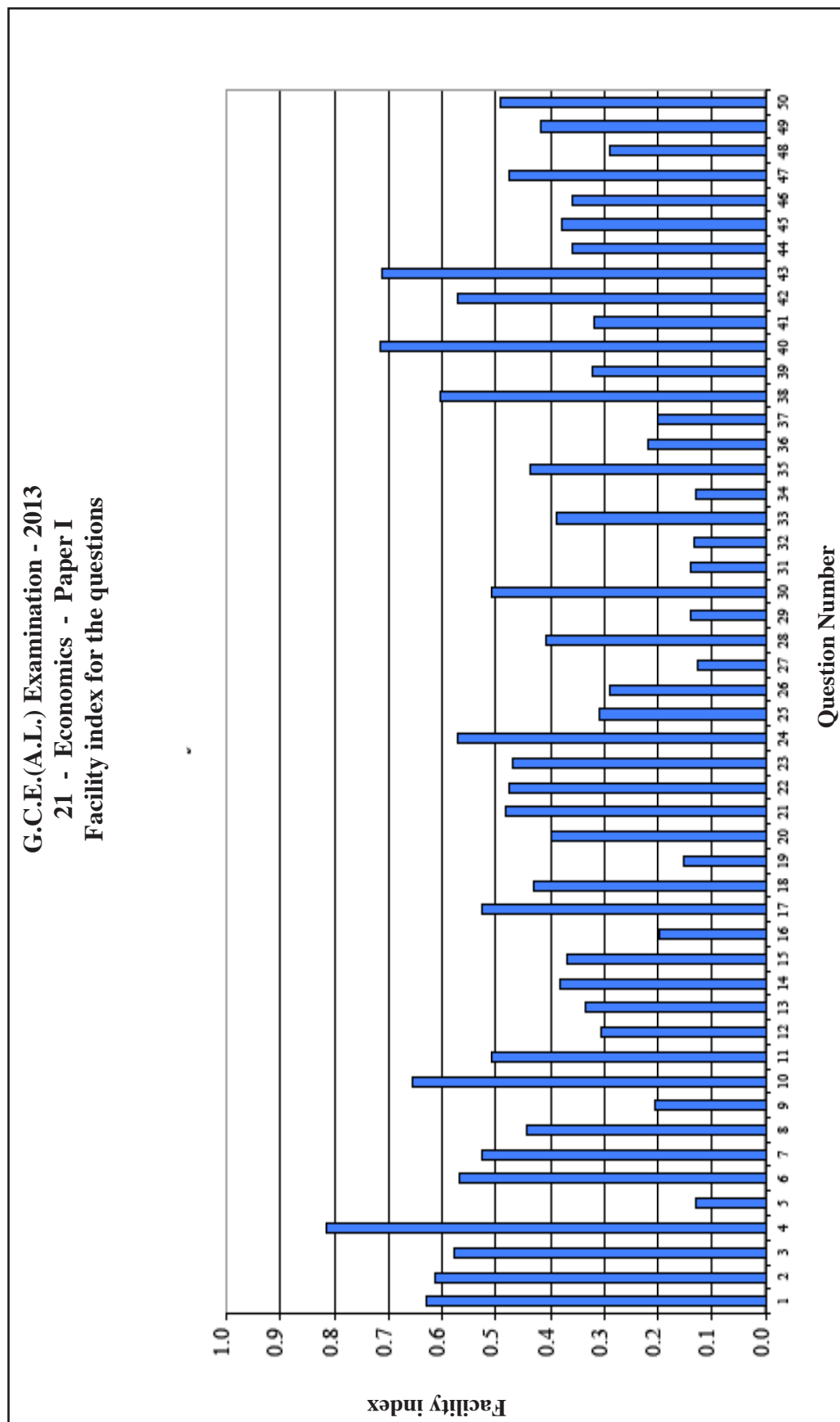
Class Interval	Frequency	Frequency Percentage	Cumulative Frequency	Cumulative Frequency Percentage
91 - 100	3	0.03	81240	100.00
81 - 90	194	0.24	81237	100.00
71 - 80	1821	2.24	81043	99.76
61 - 70	5431	6.69	79222	97.52
51 - 60	9538	11.74	73791	90.83
41 - 50	12945	15.93	64253	79.09
31 - 40	16351	20.13	51308	63.16
21 - 30	18016	22.18	34957	43.03
11 - 20	15107	18.60	16941	20.85
01 - 10	1824	2.25	1834	2.26
00 - 00	10	0.01	10	0.01

Table 4

According to the above table the number of candidates scoring from 31 - 40 is 16351. As a percentage it is 20.13%. The number scoring below 40 marks is 51308 and as a percentage it is 63.16%

1.3 Analysis of Subject Achievement

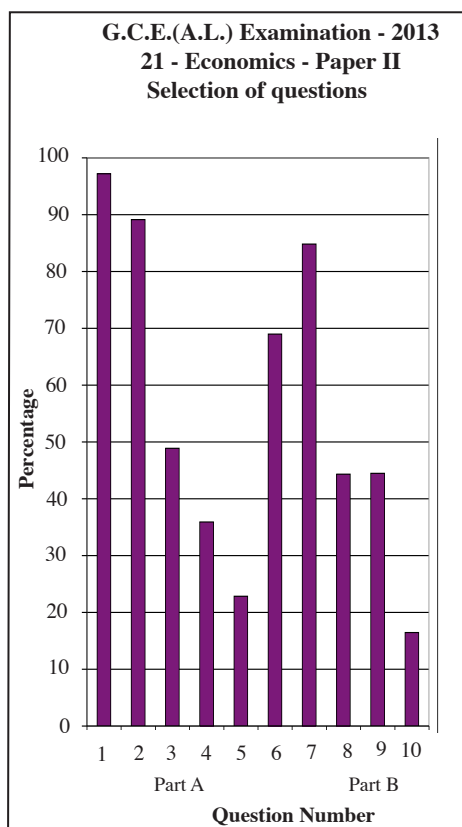
1.3.1 Achievement in Paper I



Graph 1 (Prepared using the information collected from form RD/16/05/AL)

According to the above graph the highest number of candidates have correctly responded to question 4. Its percentage is 81%. Least number of candidates have correctly responded to question 5, 27, 32 & 34. Its percentage is Approximately 13%.

1.3.2 Selection of questions in paper II

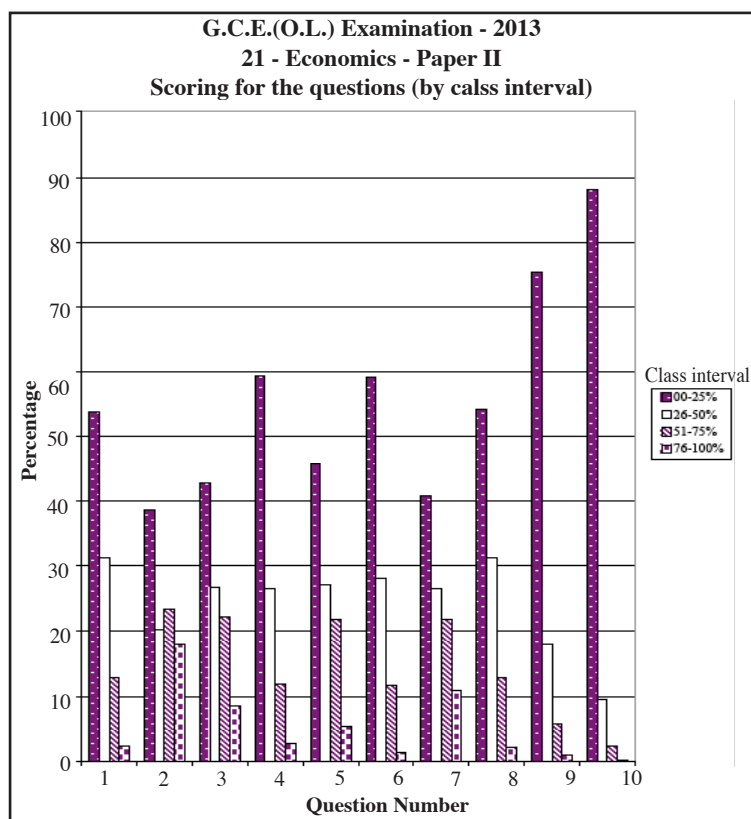


How information can be elicited from this graph is illustrated by the following example.

According to the graph, majority of the applicants have attempted the Question No 01 in part a) and its percentage is 97% but Question No 10 in part b) by few applicants. were selected and percentage is 16%.

Graph 2 (Prepared using the information collected from the form RD/16/02/AL)

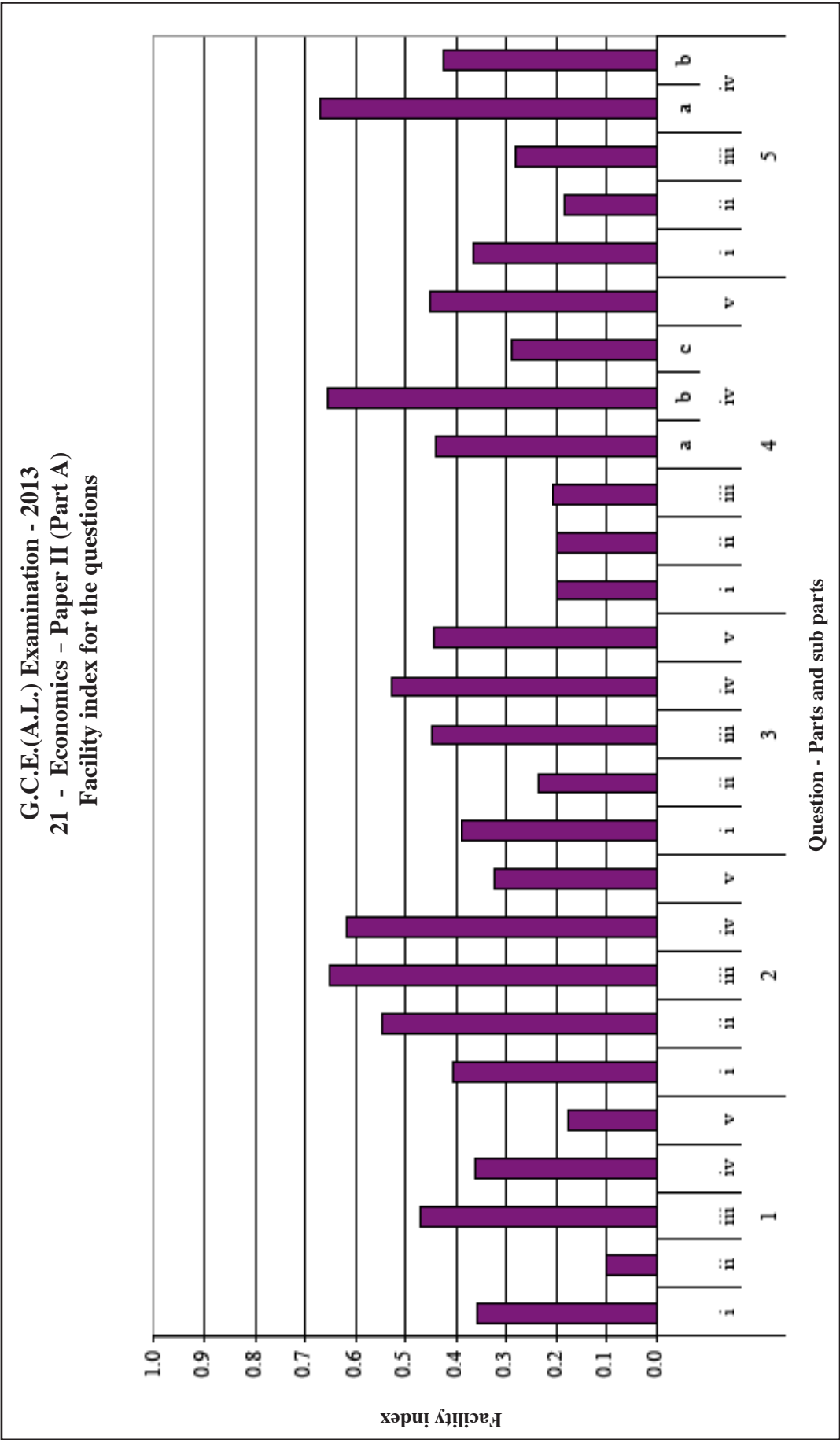
1.3.3 Scoring for the questions in paper II



20 marks allocated for question no.4. From those markes 46% -100% interval which is 16-20 marks has obtained by 3%. 0%-25% interval from allocated 20 marks which is between 0-5 marks obtained by 59%.

Graph 3 (Prepared using the information collected from the form RD/16/02/AL)

1.3.4 Achievement in Paper II



Graph 4.1 (Prepared using the information collected from the form RD/16/04/AL)
According to the graph the facility of part *a* (iii) of question 1 is about 47% and the facility of part *b* (iv) is about 66%.

G.C.E.(A.L.) Examination - 2013
21 - Economics - Paper II (Part B)
Facility index for the questions



Question - Parts and sub parts

Graph 4.2 (Prepared using the information collected from the form RD/16/04/AL)

Part II

2. Information on questions and answers

2.1 Question paper I and information on answers to paper I

2.1.1 Structure of the paper I

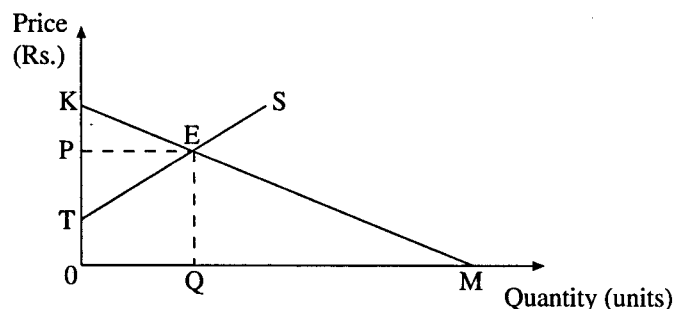
- ★ Time is 02 hours.
- ★ This multiple choice paper consisting of 50 questions. Each question has 5 choices. All questions are compulsory.
- ★ Each question carries 02 marks amounting to the total of 100 marks

2.1.2 Paper I

1. Which one of the following is a normative statement?
 - (1) Economists classify natural resources as renewable and non-renewable resources.
 - (2) The environment is an example of a scarce resource.
 - (3) Economies have limited means to satisfy unlimited wants.
 - (4) The rate of inflation in Sri Lanka at present is single digit.
 - (5) An unequal distribution of income is unfair.
2. The opportunity cost of increasing capital investment in a fully employed economy would be
 - (1) a fall in consumption.
 - (2) a fall in income.
 - (3) a rise in saving.
 - (4) a rise in the rate of interest.
 - (5) a fall in output.
3. The term 'transition economy' is used to describe a country that is
 - (1) adopting capital intensive methods in place of labour-intensive methods.
 - (2) moving from central planning towards the market system.
 - (3) moving from a low-income category to a middle-income category.
 - (4) replacing a trade deficit with a trade surplus.
 - (5) moving from a traditional economy towards central planning economy.
4. One of the important characteristics of a centrally planned economic system is
 - (1) the allocation of resources based on relative prices.
 - (2) the private ownership of resources which is fundamental to economic growth.
 - (3) the decisions taken by government planners regarding how best to produce goods and services in the economy.
 - (4) the achievement of economic efficiency superior to the market economic system.
 - (5) the very unequal distribution of income and wealth.
5. The diagram shows the market demand and supply curves for a product.

Which area measures the total amount consumers would be willing to pay for the equilibrium level of output?

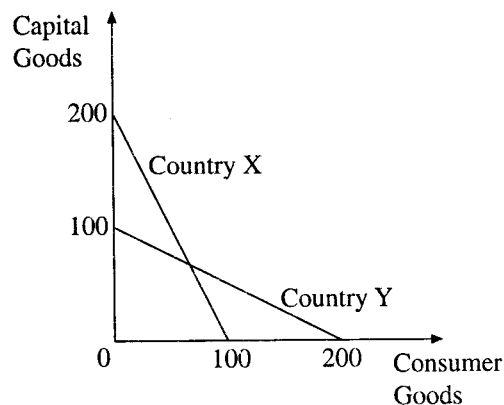
- (1) OQEP
- (2) OTEQ
- (3) PEK
- (4) OKM
- (5) OKEQ



5. The diagram shows the production possibility curves for two countries, X and Y.

Which statement about two countries is correct?

- (1) Both countries always have identical opportunity costs.
- (2) Both countries have the same future growth prospects.
- (3) The opportunity costs are increasing in both countries.
- (4) The two countries can never produce the same combination of products.
- (5) Country X has a higher opportunity cost than country Y in producing consumer goods.



7. The table below shows the cross elasticities of demand for the product of five companies with respect to the prices of their closest substitutes.

Company	Cross elasticity of demand
Company A	+ 3.0
Company B	+ 2.5
Company C	+ 1.0
Company D	+ 0.8
Company E	+ 0.2

According to this information, the company likely to possess the greatest market power would be

- (1) Company A. (2) Company B. (3) Company C. (4) Company D. (5) Company E.
8. The total revenue of the firm will decline when
- (1) price rises and supply is elastic. (2) price falls and demand is elastic.
 - (3) price rises and demand is inelastic. (4) price rises and demand is elastic.
 - (5) price falls and demand is unitary elastic.
9. If X is an inferior good, a decrease in income will,
- (1) decrease demand, decrease price, and decrease quantity demanded.
 - (2) decrease demand, increase price, and decrease quantity demanded.
 - (3) increase demand, increase price, and decrease quantity demanded.
 - (4) increase supply, decrease price, and increase quantity demanded.
 - (5) increase demand, increase price, and increase quantity demanded.
10. Suppose the market for oranges is currently in equilibrium. If the supply of oranges decreases, while at the same time the demand for oranges increases, what can you say about the price and quantity of oranges in the market?
- (1) Price and quantity both rise.
 - (2) Price rises, but the change in quantity is ambiguous.
 - (3) Price and quantity both fall.
 - (4) Quantity rises, but the change in price is ambiguous.
 - (5) Neither price nor quantity change as these shifts offset one another.
11. Suppose the price elasticity of demand for cigarettes is less than one. When an excise tax is imposed on cigarette production, it changes the price, quantity, and consumer spending in which of the following ways?

	Price	Quantity	Consumer Spending
(1)	decrease	increase	increase
(2)	decrease	decrease	decrease
(3)	increase	decrease	decrease
(4)	increase	decrease	increase
(5)	increase	increase	increase

2. Suppose the government sends each parent a coupon that can be used to subsidize the cost of sending each child to daycare. What would you expect to occur in the market for daycare services?
- (1) The demand for daycare falls, lowering the price.
 - (2) The demand for daycare rises, increasing the price.
 - (3) The supply of daycare rises, lowering the price.
 - (4) The supply of daycare falls, increasing the price.
 - (5) A permanent shortage of daycare services would exist.
13. What is necessary for consumer surplus to be zero?
- (1) Demand is perfectly price elastic.
 - (2) Demand is perfectly price inelastic.
 - (3) Supply is perfectly price elastic.
 - (4) Supply is perfectly price inelastic.
 - (5) Price elasticity of demand is relatively greater than the price elasticity of supply.
14. There will be a simultaneous increase in both price and quantity traded in the market for 'a normal good' due to
- (1) the removal of the effective maximum price on the good.
 - (2) technological progress in the production of the good.
 - (3) the imposition of the tax on the good.
 - (4) the granting of a subsidy to producers of the good.
 - (5) decrease in the price of a substitute for this product.
15. When the marginal product of labour is equal to average product of labour,
- (1) marginal product of labour is at its maximum.
 - (2) marginal cost of production is at its minimum.
 - (3) marginal cost is equal to minimum average variable cost.
 - (4) average total cost is at its minimum.
 - (5) total product of labour is at its maximum.
16. To increase its labour force from 100 to 101 workers, a firm has to increase its daily wage rate from Rs. 600 to 650. Under this situation, the marginal cost of labour per day is
- (1) Rs. 50.
 - (2) Rs. 650.
 - (3) Rs. 5,650.
 - (4) Rs. 60,000.
 - (5) Rs. 65,650.
17. An economist calculates that a firm has incurred the following production costs over the course of a year.

Item	Cost (Rs. Thousands)
Wages and salaries	150
Opportunity cost of owner's time	40
Cost of materials	80
Rent	30
Marketing fees	20
Interest on bank loans	25
Interest forgone on finance provided by owner	15

By how much does total cost as defined by an economist exceed the total cost as defined by an accountant?

- (1) Rs. 30,500.
 - (2) Rs. 55,000.
 - (3) Rs. 85,000.
 - (4) Rs. 305,000.
 - (5) Rs. 360,000.
18. **Firm A** reduces its workers from 250 to 200 and as a result its output decreases from 5,000 to 4,800 units per day. **Firm B** increases its workers from 800 to 1,000 and as a result its output increases from 2,000 to 2,200 units per day. What happens to labour productivity of the workers in the two firms?

	Labour Productivity of Firm A	Labour Productivity of Firm B
(1)	Falls	Rises
(2)	Rises	Falls
(3)	Rises	Rises
(4)	Falls	Falls
(5)	Rises	Remains unchanged

19. An industry consists of a large number of firms, all of which produce an identical product. What could explain why the demand curve facing each individual firm is downward sloping?
- (1) All firms act as price takers.
 - (2) Freedom of exit and entry.
 - (3) Perfect mobility of resources.
 - (4) A limit on the amount consumers have available to spend.
 - (5) Imperfect knowledge about the market on the part of consumers.

20. A perfectly competitive firm is producing 200 bags of rice per week, which it sells at Rs. 250 per bag. The table shows the firm's costs.

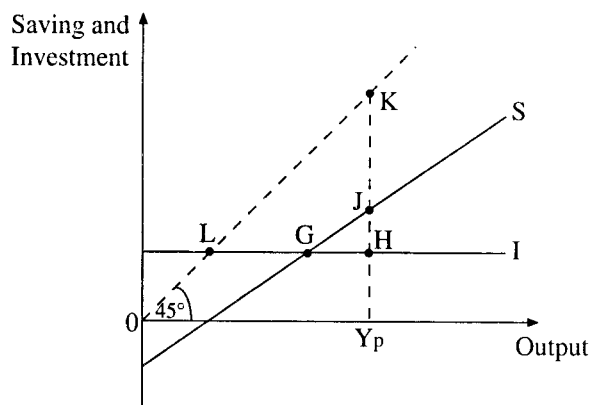
Item	Cost (Rs.)
Total fixed cost	20,000
Total variable cost	40,000
Marginal cost	250

In the short run, what should the firm do to maximize profits or minimize its losses?

- (1) Cease production altogether.
 - (2) Increase its output.
 - (3) Decrease its output.
 - (4) Lower its price.
 - (5) Maintain its output at present level.
21. Which of the following would **not** affect the size of real GDP?
- (1) A consumer purchases a new car for personal use.
 - (2) The government purchases a new bus for the defence academy.
 - (3) A consumer purchases a haircut from a hairdresser.
 - (4) An investor purchases a rare renaissance painting at an auction.
 - (5) A firm purchases a new power generator for its factory.
22. Suppose that autonomous consumption is Rs. 400 and that the marginal propensity to consume is 0.8. If disposable income increases by Rs. 1,200, consumption spending will increase by
- (1) Rs. 1600.
 - (2) Rs. 1360.
 - (3) Rs. 1200.
 - (4) Rs. 960.
 - (5) Rs. 400.
23. In a closed economy with only lump-sum taxation, if the marginal propensity to save is equal to 0.25, a Rs. 80 billion increase in government purchases could cause a maximum increase in output of
- (1) Rs. 80 billion.
 - (2) Rs. 80.25 billion.
 - (3) Rs. 160 billion.
 - (4) Rs. 240 billion.
 - (5) Rs. 320 billion.
24. In a closed economy with no government, $C = 30 + 0.7Y$, where C is consumption and Y is income. The equilibrium level of income is Rs. 300 million. What is the level of investment?
- (1) Rs. 60 million.
 - (2) Rs. 100 million.
 - (3) Rs. 210 million.
 - (4) Rs. 240 million.
 - (5) Rs. 300 million.
25. The diagram below shows the saving and investment curves of a closed economy with no government.

The potential level of output is Y_p . Therefore, the gap between actual and potential output can be measured by the distance

- (1) LG.
- (2) GH.
- (3) JH.
- (4) KJ.
- (5) HK.



26. In one year, total spending on consumption, investment and government purchases was equal to 103 percent of a country's Gross Domestic Product. This would be possible only if
- (1) the money supply increased.
 - (2) net exports were positive.
 - (3) net exports were negative.
 - (4) the government ran a budget surplus.
 - (5) the government had a balance budget.

27. A closed economy has a banking system consisting of a single bank. The bank operates with a reserve ratio of 10%. Customers deposit Rs. 10,000 in cash. Assuming no subsequent change in notes and coins in circulation what is the maximum amount of loans that the bank can grant?
- (1) Rs. 1,000 (2) Rs. 9,000 (3) Rs. 10,000 (4) Rs. 90,000 (5) Rs. 100,000

28. According to Keynesian theory, in which circumstances would there always be an increase in the demand for money?

	Real Income	Price Level	Interest Rates
(1)	increase	decrease	increase
(2)	constant	constant	increase
(3)	increase	increase	decrease
(4)	constant	decrease	decrease
(5)	decrease	constant	increase

29. Assume that the economy is at full employment. Policymakers wish to maintain the price level stable but want to encourage greater investment. Which of the following combinations of monetary and fiscal policies would best achieve this goal?

	Monetary Policy	Fiscal Policy
(1)	no change	contractionary
(2)	expansionary	no change
(3)	expansionary	contractionary
(4)	expansionary	expansionary
(5)	contractionary	expansionary

30. Which of the following policy choices represents a combination of fiscal and monetary policies designed to bring the economy out of a recession?

- (1) Decreasing both taxes and the money supply.
- (2) Increasing both taxes and the money supply.
- (3) Increasing government spending and decreasing the central bank interest rates.
- (4) Increasing both taxes and the discount rate.
- (5) Engaging in deficit budgeting and selling securities in the open market.

31. In an economy, the volume of output rises by 2% in a year, while the quantity of money rises by 5%. If the velocity of circulation of money remains the same, what will be the approximate increases in the price level and the nominal value of total output?

	Increase in price level	Increase in nominal value of total output
(1)	2%	5%
(2)	2%	7%
(3)	2.5%	10%
(4)	3%	5%
(5)	3%	7%

32. The following table gives index numbers for a measure of an economy's nominal value of Gross Domestic Product for the period 2008 - 2012.

Year	Nominal Value of Gross Domestic Product (GDP)
2008	100
2009	96
2010	90
2011	85
2012	83

From the data it can be concluded that from 2008 - 2012 there must have been a fall in

- (1) aggregate demand.
- (2) real output.
- (3) the rate of inflation.
- (4) the government's budget deficit.
- (5) deficit in the trade balance.

33. Which consequence of building a new railway line would be classified as a positive externality?
- (1) A reduction in road accidents.
 - (2) The increase in profits for the Railways Department.
 - (3) The increase in revenue from tourists traveling on the line.
 - (4) The saving in travel time by passengers who travel on the line.
 - (5) A reduction in the value of real estate located close to the line.
34. 'A merit good' is a
- (1) good that is made available to consumers according to merit.
 - (2) good that the government believes consumers will buy too little of it if it is provided by free market.
 - (3) good that the government believes consumers will buy too much of it if it is provided by free market.
 - (4) good where any benefit obtained by one consumer is extended to all consumers.
 - (5) good where the private benefits of consuming the good exceed its social benefits.
35. A regressive tax is defined as one where
- (1) all tax payers pay the same absolute amount of their income in taxation.
 - (2) high income earners pay a lower proportion of their income in taxes than low income earners.
 - (3) high income earners pay less in taxes than low income earners.
 - (4) high income earners pay more in taxes than low income earners.
 - (5) the tax burden can be shifted backward.
36. The table below shows the number of goods X and Y which the two countries A and B produce using a composite resource unit.
- | Product | Country A | Country B |
|---------|-----------|-----------|
| Good X | 100 | 300 |
| Good Y | 200 | 400 |
- Assume that each country specializes in the product in which it has a comparative advantage. The rate of exchange suitable for each country to gain from trade would be,
- (1) $1X = 1Y$
 - (2) $1X = 1.3Y$
 - (3) $1X = 1.5Y$
 - (4) $1X = 2Y$
 - (5) $1X = 3Y$
37. A Sri Lankan manufacturing firm exports US \$ 10 million worth of tires to a company in the UK. According to the double-entry accounting system, which two parts of the balance of payments accounts will be affected by this transaction?
- (1) Exports in current account and capital transfers in capital account.
 - (2) Exports in current account and incomes in current account.
 - (3) Exports in current account and reserve assets in financial account.
 - (4) Liabilities in financial account and claims on non-residents in financial account.
 - (5) Exports in current account and claims on non-residents in financial account.
38. The Department of Statistics of a country wishes to present its final balance of payments account. It has calculated the current account balance, the capital account balance and financial account balance. The additional information required to complete the task is
- (1) change in foreign currency reserves.
 - (2) foreign aid.
 - (3) errors and omissions.
 - (4) speculative currency flows.
 - (5) change in portfolio investment.
39. A country's terms of trade currently stands at 150 (base year 2010 = 100). Since 2010 the average price the country has received for its exports has increased by 20%. Thus, the average price it has paid for its imports should have changed by
- (1) -50%.
 - (2) -25%.
 - (3) -20%.
 - (4) +20%.
 - (5) +25%.
40. Assume that a representative basket of goods costs \$ 120 in the United States. The same basket of goods costs Rs. 9,600 in Sri Lanka. It can be deduced from this that the
- (1) external value of the rupee is 25% overvalued.
 - (2) external value of the rupee is 20% undervalued.
 - (3) purchasing power parity exchange rate is Rs. 96 per dollar.
 - (4) purchasing power parity exchange rate is Rs. 80 per dollar.
 - (5) purchasing power parity exchange rate \$ 0.10 per rupee.

41. Foreign direct investment in developing economies is likely to result
- (1) a reduction in local wage levels.
 - (2) a reduction in tax revenues in developing economies.
 - (3) a reduction in the range of consumer goods available to the local population.
 - (4) a worsening of net foreign income flows from investments.
 - (5) a worsening of the capital account of the balance of payments.
42. What is typically associated with a relatively low level of income per capita in a country?
- (1) A high rate of saving.
 - (2) A low rate of economic growth.
 - (3) A low rate of inflation.
 - (4) A low rate of population growth.
 - (5) A high rate of employment.
43. A combination of factors which is most likely to generate a more rapid economic growth is
- (1) an increase in employment and in the balance of payments deficit.
 - (2) an increase in the level of investment and in the size of the working population.
 - (3) more equal distribution of wealth and a higher level of transfer payments.
 - (4) more rapid inflation and an increase in the national debt.
 - (5) an increase in foreign direct investment and increase in interest rates.
44. The table below shows, for a given year, the figures for consumption, gross capital formation and depreciation in five countries, namely, A, B, C, D and E. (All measured in millions of US dollars.)

Country	Consumption	Gross Capital Formation	Depreciation
A	200	40	50
B	500	200	150
C	1000	1200	1400
D	5000	6000	6000
E	10000	8000	8200

Given the state of technology remains unchanged, the country which is most likely to experience economic growth is,

- (1) A
 - (2) B
 - (3) C
 - (4) D
 - (5) E
45. Supply-side policies are generally understood to be policies which
- (1) improve productivity and reduce market imperfections.
 - (2) enable the government to supply as many goods and services as possible.
 - (3) reduce the supply of labour in order to minimize the problem of unemployment.
 - (4) reduce inflation by controlling interest rates.
 - (5) promote aggregate demand.
46. The table below shows the share of total income of different income groups in an economy in 2000 and 2010.

Income group	% share of total income	
	2000	2010
Bottom 10%	4.1	2.5
Bottom 20%	9.8	6.8
Bottom 30%	16.0	12.0
Top 30%	47.0	54.0
Top 20%	35.0	41.0
Top 10%	20.0	26.0

From the data it may be concluded that over the period in question

- (1) the bottom income groups experienced a fall in their income.
- (2) the distribution of income became more unequal.
- (3) the distribution of wealth became more unequal.
- (4) everyone became better off because total income increased.
- (5) the Gini coefficient has decreased.

47. Which one of the following changes would best indicate that a country has experienced development?
- (1) An improvement in the average citizen's quality of life.
 - (2) An increase in the country's real GDP.
 - (3) An improvement in the country's trade balance.
 - (4) An appreciation in the country's currency.
 - (5) An increase in the adult literacy rate.
48. Economists have proposed that the best policy to promote development is "trade not aid". The implication of this proposal is that developing countries should
- (1) become self-sufficient and not rely on aid.
 - (2) be given greater access to markets in developed countries.
 - (3) use foreign aid to invest in their export industries.
 - (4) use trade barriers to promote import substitution.
 - (5) promote development by achieving a surplus in the trade balance.
49. Some of the demographic data for country X is given in the following table:

Item	Number (in million)
Total population	180
Population (10 years and over)	150
Employed population	81
Unemployed population	9
Population not economically active	60

Based on the above information, what is the answer that shows the unemployment and labour force participation rates for country X?

	Unemployment Rate	Labour Force Participation Rate
(1)	10.00%	60.00%
(2)	10.00%	53.33%
(3)	6.66%	50.00%
(4)	5.55%	50.00%
(5)	5.65%	33.33%

50. In a given economy, both employment and unemployment rose over a period of ten years. This situation must have been produced by the increase in
- (1) birth rate.
 - (2) economically active population.
 - (3) life expectancy.
 - (4) dependency ratio.
 - (5) out migration.

* * *

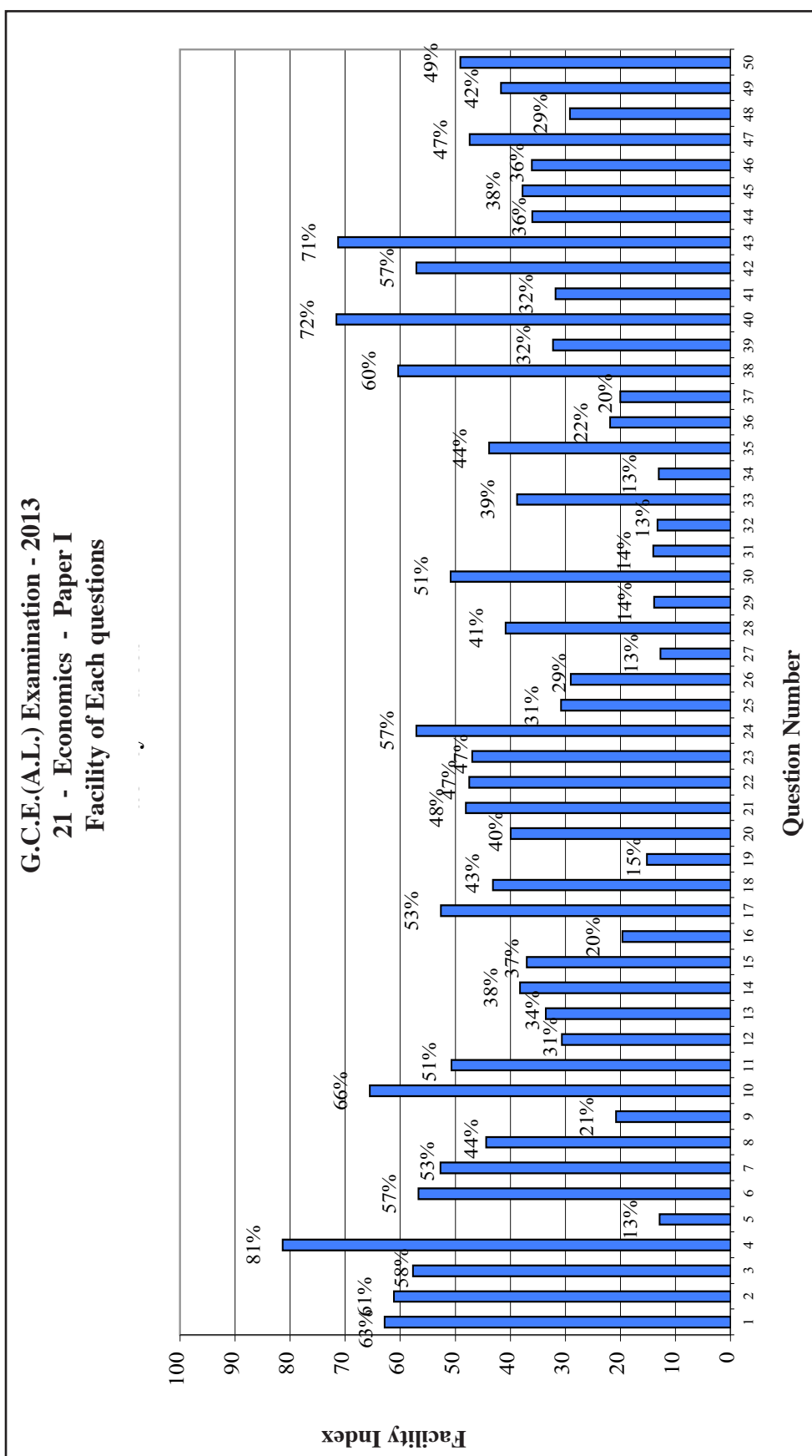
2.1.3 Expected answers and the marking scheme for Paper I

Marking Scheme - Paper I

Question No.	Answer	Question No.	Answer
01.	5	26.	3
02.	1	27.	4
03.	2	28.	3
04.	3	29.	5
05.	5	30.	3
06.	5	31.	4
07.	5	32.	1
08.	4	33.	1
09.	5	34.	2
10.	2	35.	2
11.	4	36.	3
12.	2	37.	5
13.	1	38.	3
14.	1	39.	3
15.	3	40.	4
16.	3	41.	4
17.	2	42.	2
18.	2	43.	2
19.	5	44.	2
20.	5	45.	1
21.	4	46.	2
22.	4	47.	1
23.	5	48.	2
24.	1	49.	1
25.	2	50.	2

Each correct answer carries 02 marks, amounting the total to 100.

2.1.4 Observations on the responses to Paper I (by subject area) :



According to the above graph the lowest facilitation percentage in the paper 01 is for the question no 27. Its 12.7%. Further the highest facility percentage, 81.3% is for the question 04 which is answered by majority of students is 81.3%.

As a whole the facilitation percentage of in paper 01 is 56.45%

2.1.5 Responses to the options in Paper I - as a percentage

Question Number	Correct Answer	Percentage of students selecting each option					
		1	2	3	4	5	Missing
1	5	10.78	7.17	8.50	10.33	62.83	0.33
2	1	61.11	10.83	13.83	10.28	3.83	0.11
3	2	10.17	57.67	9.72	10.33	11.89	0.22
4	3	6.33	4.94	81.33	5.28	1.83	0.28
5	5	44.28	6.28	33.33	3.06	12.83	0.22
6	5	21.39	4.61	4.11	12.72	56.61	0.56
7	5	24.44	3.06	14.89	4.50	52.67	0.44
8	4	7.06	18.17	17.89	44.33	12.06	0.50
9	5	13.06	10.50	20.72	13.78	41.61	0.33
10	2	17.44	65.50	3.67	5.50	7.72	0.17
11	4	2.00	3.33	34.33	50.67	9.44	0.22
12	2	11.28	30.56	36.06	11.06	10.83	0.22
13	1	33.50	26.56	9.78	11.33	18.28	0.56
14	1	38.22	27.00	10.44	8.83	15.17	0.33
15	3	8.11	10.33	36.94	15.06	28.28	1.28
16	3	61.28	7.67	19.61	2.89	8.17	0.39
17	2	8.22	52.56	15.89	12.11	9.94	1.28
18	2	23.39	43.11	6.00	6.28	21.06	0.17
19	5	24.78	29.28	16.39	14.22	15.11	0.22
20	5	11.33	32.22	10.00	5.94	39.89	0.61
21	4	6.07	8.17	32.72	48.06	4.00	0.28
22	4	11.50	22.61	10.06	47.44	7.56	0.83
23	5	12.00	12.94	11.94	15.33	46.89	0.89
24	1	57.06	6.44	11.50	19.72	4.28	1.00
25	2	5.67	30.72	22.17	24.94	16.06	0.44
26	3	18.06	21.72	29.00	25.33	5.17	0.72
27	4	11.17	63.83	4.78	12.67	7.06	0.50
28	3	14.22	10.00	40.78	23.50	10.83	0.67
29	5	22.78	24.06	21.89	16.56	13.83	0.89
30	3	10.50	10.00	50.78	5.78	22.33	0.61
31	4	18.94	16.11	33.61	14.00	15.83	1.50
32	1	13.22	42.72	25.78	8.22	9.44	0.61
33	1	38.72	8.94	11.78	33.72	6.28	0.56
34	2	2.33	13.00	11.72	47.83	24.44	0.67
35	2	7.72	43.78	14.44	18.94	14.39	0.72
36	3	13.83	35.50	21.83	20.28	7.28	1.28
37	5	11.06	46.61	20.00	4.22	17.50	0.61
38	3	13.28	8.78	60.33	6.83	10.17	0.61
39	3	12.28	15.11	32.22	23.94	14.17	2.28
40	4	4.89	9.17	8.56	71.56	5.00	0.83
41	4	10.72	24.11	11.50	31.78	21.17	0.72
42	2	8.67	57.00	15.44	9.11	8.94	0.83
43	2	7.44	71.28	9.72	3.39	7.72	0.44
44	2	12.67	36.00	13.06	25.78	11.56	0.94
45	1	37.72	15.17	19.11	13.72	13.44	0.83
46	2	21.78	36.06	9.11	14.50	17.56	1.00
47	1	27.33	27.33	10.44	9.44	4.78	0.67
48	2	25.11	29.11	20.00	10.33	14.94	0.50
49	1	41.67	14.78	16.78	17.28	8.22	1.28
50	2	19.50	49.06	10.28	13.44	7.33	0.39

* Under each question the percentage of selecting the correct option is shaded.

* 'Missing' indicates the percentage of students selecting more than one option or none.

2.1.6 Overall observations, conclusions and suggestions regarding the answers to Paper I :

- ★ In overall for the multiple choice questions (Paper I) numbers 01, 02, 04, 10, 38, 40 and 43 records the highest level of performance. Out of total candidates more than 60% obtained the correct answers for these questions.
- ★ Out of total candidate only less than 40% enable to provide correct answers.
- ★ For the Question no s 05, 12, 13, 14, 15, 16, 19, 25, 26, 27, 29, 31, 32, 33, 34, 36, 37, 39, 41, 44, 45, 46 and 48, out of total candidates only less than 40% enable to provide the correct answer.
- ★ The percentage of candidates who has chosen the correct choice for question no 05 is 12.83%. The question was based on market equilibrium diagram through which the students were expected to identify the total amount that consumers who are willing to pay at the equilibrium level. But the students have opted for choices such as consumer surplus and the total expenditure at the equilibrium level. Thus there should be much focus on the concepts of consumer surplus, total amount which the consumers are willing to pay at the equilibrium level and the total expenditure at this level.
- ★ The question no 12 was directed to identify the effect on the market equilibrium when the consumers were given a subsidy. 69% of the total candidates choosing a wrong answer depicts that the majority were unable to identify whether a consumer subsidy directly affects the demand or supply. Therefore the students were unable to decide its effect on the equilibrium price and the quantity.
- ★ Question no 13 was directed to identify the distribution of consumer and producer surplus based on the demand and supply elasticity. Due to the limited knowledge on the subject area has caused 66% opting for the wrong choice. Thereby it is suggested to organize the teaching-learning methods to give a clear understanding on the above area.
- ★ Question no 14 was aimed to identify the effect on the markets due to the government intervention to the market system. Here, 62% of the candidates were unable to identify the correct answer. Hence, the students should be given a clear understanding on the effect of the government intervention to the market system and the effects when there is no government intervention.
- ★ Question no 16 was directed to analyze the relationship among variable inputs and marginal cost of a production firm. 80% of the candidates have failed in this question mainly due to lack of knowledge in calculating the change in marginal cost as a result of an increased in total cost due to change in total variable input cost. Thereby, it is important to give a clear understanding on the way how the marginal cost change when a change in the prices of variable inputs.
- ★ Question no 19 was directed to analyze the market performance based on the position of the demand curve of a firm. 85% of the candidates failed to answer this question as their limited knowledge to decide on the factors affecting the downward sloping demand curve of an industry and the horizontal demand curve of a firm operating in the industry.
- ★ Question no 25 was designed to identify the ability to calculate the production gap based on the equilibrium production level of a basic economic system. 69% of the total candidates were unable to differentiate the concepts of actual production level from the expected production level (full employment and production level). Thus, the student's ability to decide the equilibrium production level and the expected production level should be enhanced.

- ★ The question no 26 was to identify the factors that contribute to the difference between the gross domestic product and the gross domestic expenditure. Net exports is the difference between the gross domestic product and the gross domestic expenditure Accordingly only 39% of the candidates have been able to decide that the value of the net exports may assume a positive or a negative sign and the gross domestic product is greater than the gross domestic expenditure when net exports are negative. Therefore the students should be given the knowledge in calculating the difference between the gross domestic product and gross domestic expenditure when the value of net exports is a positive or a negative figure.
- ★ The question no 27 was an exercise related to money creation of commercial banks. Only less than 13% of the candidates had understood that money could be created when the commercial bank system consists of one bank. Hence the students should be made aware that a single bank in a banking system can also create money similar to a banking system comprising with more banks as well.
- ★ The question no 29 investigates how financial and state monetary policies could be used to increase investment while maintaining the price stability as a macroeconomic objective. Accordingly, the students should be made aware of the possibility of the use both financial and government monetary policies simultaneously in the opposite direction to each other. This will result in increase of aggregate demand caused by increase in the government investments, which can become a reason for price instability.
- ★ The 31 question intends to investigate the ability of the students to analyze the components of the equation of quantity theory of money, $MV=PY$. The change in price levels and the gross national product based on the percentage change in the gross national production and the percentage change in the money stock has been accurately identified by only 14% of the candidates. As such the teaching-learning process should be organized so that the relationship between the components of the equation of the quantity theory of money is numerically emphasized with examples.
- ★ By the question 32, the factors affecting the change in nominal gross domestic production at the current price levels within a given period of time are investigated. For that a low percentage of students about 13% have correctly responded. According to the given data 87% of the candidates have failed to identify that decrease in the aggregate demand has caused to decrease in the production level. Subject matters should be taught so as to confirm that the relationship between the aggregate demand and the gross domestic product.
- ★ The intention of the question no 35 was to investigate the knowledge of the students with regard to classification of taxes. 56% of the candidates had given incorrect responses here due to their inability to determine the classification of taxes based on the income and tax percentage. Therefore class room teaching-learning process should be designed in order to enhance specific knowledge among the students about the classification of taxes based on tax percentage the personal income.
- ★ Question 34 was about to investigate the knowledge on the welfare goods. 87% of the candidates have however been unable to decide that the consumption level below the optimum consumption level when under the market failure situations. The students' should be made aware to categories the goods by considering the market failure situations and government intervention in such situations.

- ★ The knowledge on determination of ratio of mutual beneficial trade was tested by the question no 36. Only 22% of the candidates had responded to that question correctly. Students should be made aware of the rate of mutually beneficial trade based on the opportunity cost.
- ★ Question 37 was directed to test the knowledge on the dual record system on foreign transactions and trade balance in the balance of payment. By 82% of incorrect responses, it is clear that most of the students do not have the skill in recording them in the balance of payment. Therefore students' knowledge on balance of payment transactions should be improved.
- ★ Question 39 was directed to measure the competency on the calculations of terms of trade. 32% had selected the correct answer for that question. The competency of calculation of terms of trade as a result of change in exports and import prices should be enhanced.
- ★ Question 41 was aimed at investigating the effect of use of foreign direct investments as a source of capital formations. 68% of the candidates fail in this question indicate that the majority of the candidates had not got this knowledge. Hence the knowledge among the students on the benefits and costs of foreign direct investments should be broadened.
- ★ Question no 44 had been directed to investigate the knowledge and understanding of the students on the net investments and its determinant factors that affect on economic growth. Only 36% of the candidates enable to provide correct answer indicate that the understanding of the students of the above topic should be further developed.
- ★ The question no 45 is with regard to the identification of the supply side policies. Only less than 38% being the percentage of the correct answer provided reveal that the competency is not with the majority of the students. Therefore development of the knowledge on the macroeconomic policies and its role on the economy should be directed in the teaching-learning system.
- ★ Question 46 referred to conclusions arrived at the distribution of income according to the classification of income groups. As 64% of the candidates did not display the competency and understanding on the relative income distribution, the knowledge on relative income distribution should be provided with the aid of statistics, diagrams and tables.
- ★ Question 48 had its focus on the understanding of the students on the development policies. What is revealed by the 71% of wrong responses is that the students' knowledge is not sufficient to decide whether foreign aid or foreign trade is more suitable for development with reasons. Therefore students' competency on a balanced analysis of foreign aid and foreign trade as development policies should be enhanced.

2.2 Paper II and information on answers

2.2.1 Structure of the Paper II

Time is 3 hours.

This paper consists of 2 parts

Part 'a' – 05 Descriptive questions

Part 'b' – 05 Descriptive questions

05 questions should be answered selecting at least one from each part.

Each question carries 20 marks amounting to total 100 marks

Final marks calculation :

Paper I = 100

Paper II = 100

Final Marks = $200 \div 2$ = 100

2.2.2 Expected answers, marking scheme and observations and conclusions related to paper II

- ★ The observations related to the answers for Paper II have been presented by the graphs 2, 3, 4.1 and 4.2.

Question 1

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)
- (iv) What conditions must be satisfied if resources are used efficiently in the economy? (04 marks)
- (v) How does the production possibility frontier help to illustrate the microeconomic and macroeconomic issues in the economy? (04 marks)

Expected answer and the marking scheme

01. (i) Capital is a produced factor of production. They are real assets such as factories, equipment, stocks of raw materials etc.
Human capital refers to the stock of competencies, knowledge and social and Personality attributes acquired through education and training by individual Workers is called human capital. (03 marks)
- Human capital is less tangible than physical capital.
 - Human capital has characteristics of both labour and capital.
 - Unlike in investment in other forms of capital, investment in humans is tied to a specific person. (01 mark for any one difference)
- (ii) - Specialization and division of labour must be accompanied by trade. People who produce only one thing must trade most of it in order to obtain all the other things that they require. (01 mark)
- Early free market economies used barter, the trading of goods directly for other goods. But barter is costly in terms time spent searching out satisfactory exchanges. With barter there will be less specialization because of the difficulty of overcoming the coincidence of wants. (01 mark)
 - To avoid its cumbersome nature, money evolved. Money eliminates barter by separating transactions. If a farmer has paddy and wants cloth, he does not have to find someone who has cloth who wants paddy. They merely have to find someone who wants paddy. The farmer takes the money in exchange, then finds another person who

wishes to sell cloth, and then gives up money for cloth. Money becomes the medium of exchange. (01 mark)

- By eliminating the cumbersomeness of barter, money greatly facilitates trade and specialization. The existence of money greatly expands the possibilities of specialization and trade. (01 mark)

(iii) Market system:

- The private ownership of resources and the use of markets and prices to coordinate and direct economic activity characterize the market economy.
- In that system, each participant acts in his or her own self-interest; each individual or business seeks to maximize its satisfaction or profit through its own decisions regarding consumption or production.
- Goods and services are produced and resources are supplied by whoever is willing and able to do so.
- The result is competition among independently acting buyers and sellers of each product and resource. Thus, economic decision making is widely dispersed.
- Government's role would be limited to protecting private property (02 marks)

Command System:

- In the command system, government owns most property resources and economic decision making occurs through a central economic plan. A central planning board appointed by the government makes all the major decisions concerning the use of resources, the composition and distribution of output, and the organization of production.
- The government owns all the business firms, which produce according to government directives.
- A central planning board determines production goals for each enterprise and specifies the amount of resources to be allocated to each enterprise so that it can reach its production goals.
- The division of output between capital and consumer goods is centrally decided, and capital goods are allocated among industries on the basis of central planning board's long-term priorities. (02 marks)

Alternative Answer:

Market Economy:

- Three fundamental economic questions (what, how and for whom) are solved through price mechanism. Those goods and service that can be

produced at a profit will be produced and those whose production entails a loss will not. The decisions will be made on the basis of price signals coming from the goods markets and factor markets.

- In a market system producers will employ the most efficient techniques of production based on the available technology and the prices of resources they use.
- Individual incomes are determined by the quantity of resources owned by individuals and the prices of the resources. Factor prices are determined by the interaction of supply and demand in the factor market. **(02 marks)**

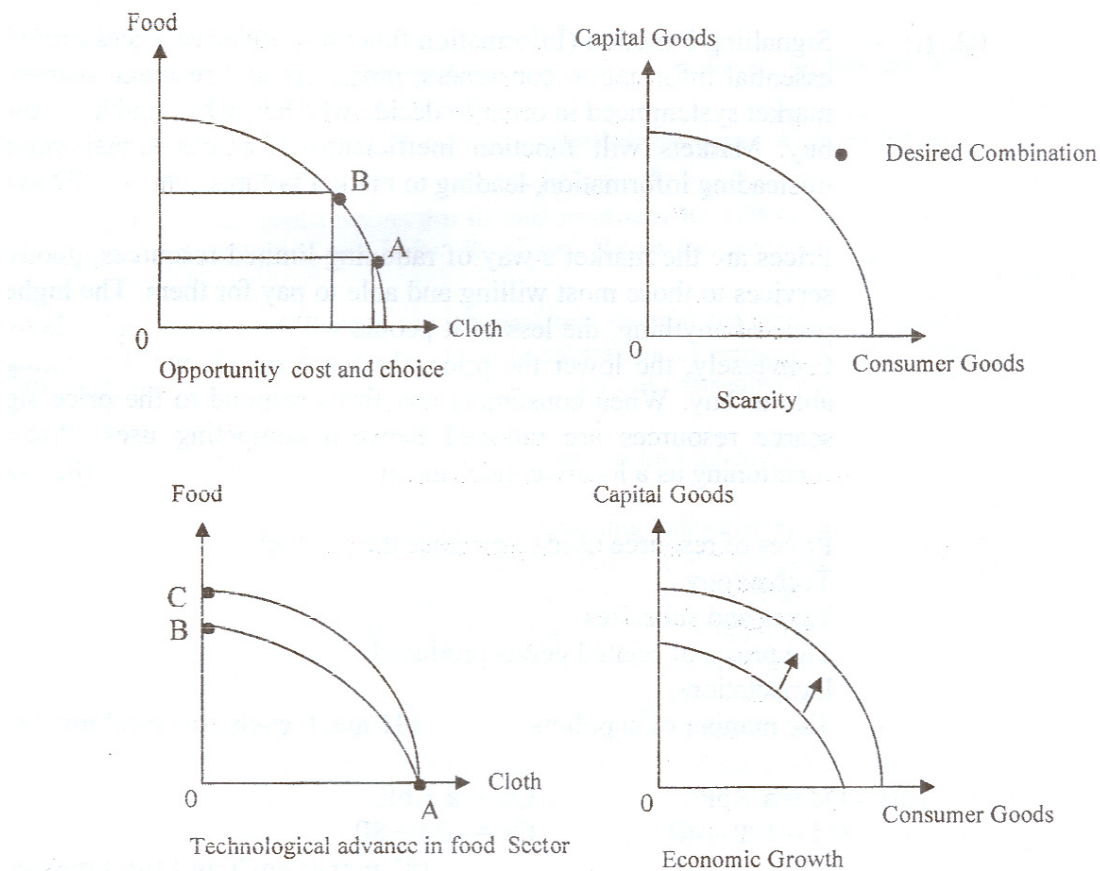
Command economy:

- In a command economy, allocation of resources is done by a decree issued by the Central Planning Agency. In this case they set the prices of goods and leave individuals to buy what they wish at the state-controlled prices.
 - Methods of production are selected by the central planning authority. The distribution of products and of incomes is largely set centrally. The government decides wage rates and prices of goods and services. **(02 marks)**
- (iv) - Two conditions should be satisfied: (a) Productive Efficiency and (b) Allocative Efficiency
- Productive Efficiency: Productive efficiency is the production of any Particular mix of goods and services in the least costly way. (Maximum Output per unit of input or minimum amount of inputs per unit of output. **(01 mark)**
 - To achieve this it must realize both (a) full employment and (b) full Production **(01 mark)**
 - Allocative efficiency means that resources are allocated to produce Goods and services most wanted by society. **(01 mark)**
 - This situation is achieved when the marginal cost of producing each good is equal to its price: $MC = P$ **(01 mark)**
- (v) - Microeconomics studies individual units while macroeconomic issues involve aggregates for the economy.
- Microeconomic applications:
 - (i) Problem of scarcity
 - (ii) Choice of different combinations of goods
 - (iii) Opportunity cost and choice
 - (iv) Impact of technology change **(02 marks)**

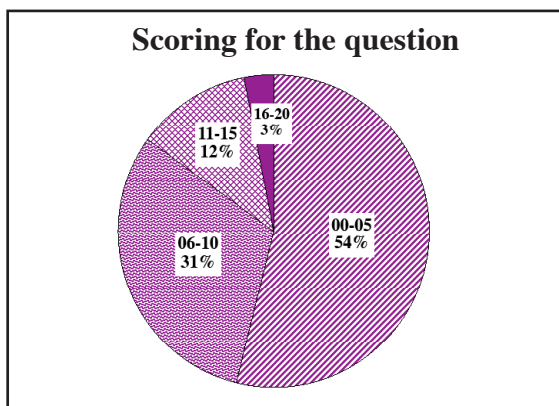
- Macroeconomic applications:
 - (i) Economic growth
 - (ii) Full employment and underemployment
 - (iii) Economic recession and declines
 - (iv) Effects of economic sanctions (02 marks)

Combinations of two outputs that can be produced with full Employment of resources.

- Economic growth, unemployment are macro representations while Opportunity cost and scarcity can be micro applications. Some aspects Can be shown either for an economy an individual firm.

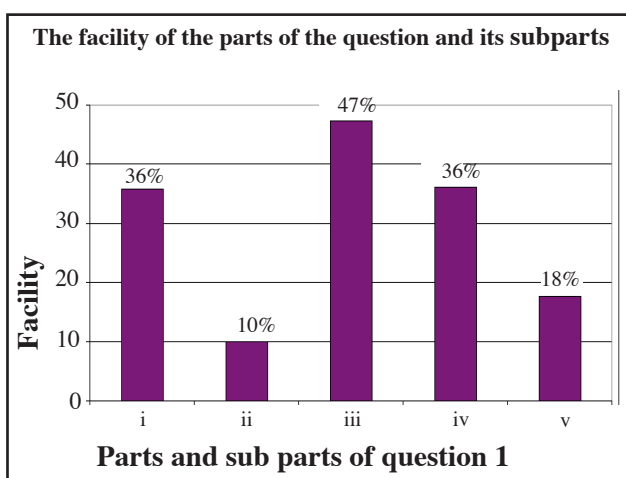


Overall observations and conclusions regarding the answers to Question 1 :



Although question 1 is compulsory, 98% have answered it. 100 marks have been allocated for this question. The percentages of candidates scoring within the following four intervals are:

00 - 25	–	30%
26 - 50	–	45%
51 - 75	–	20%
76 - 100	–	5%



This question has 05 sub parts. Part (ii) has the lowest facility percentage and it was 10%. Also, Meanwhile part (iii) has been the easiest question where the percentage is 47%.

- ★ The facility percentage for part I was 36%. Due to the inability to define the two concepts : capital and human capital the proficiency level was in a very low level. One of the factors that affected the low level of easiness was that to some students had defined only one concept. Therefore when the difference between the concepts are tested, the students should be given the competence to define both the concepts not being limited to it and present alternative differences.
- ★ The facilitation of part II is a low percentage as 10%. It is a question directed to investigate the ability to analyze the relationship among specialization, division of labour and usage of money. Despite the students had the ability to explain the three concepts of specialization, division of labour and the usage of money, they did not have the competency to able to develop the relationship among them. Therefore the existence of 90% difficulty is disappointing. The students should be given the capability to describe that In explaining the answer that the specialization and division of labour are interconnected with trade, how money became useful to overcome difficulties in the barter system that people are led to the division of labour and specialization as a result and the explaining competence and creativity of the students should be developed.
- ★ The part III, the most easiest part of the first question has been set to test the competence of differentiation between the market economic system and command economic system. Facilitation of this was 47% and a question constantly tested in the past papers. Therefore attention should be paid on the definite analysis among the economic systems of 47% is not encouraging.

- ★ The conditions that should be fulfilled for the effective use of the scarce resources were investigated by the part IV and it was 36%. With regards to this, the majority of the students had failed to note that the both conditions of the production efficiency and allocative efficiency should be fulfilled and the other two conditions i.e. total production and full employment are essential for the production efficiency. Therefore the teaching-learning process should be improved highlighting the facts related to the subject concepts.
- ★ The part V investigates the ability to explain the concepts relating to micro and macroeconomics and their production possibility frontiers. The facilitation of this is 18%. It is not a satisfactory level as the usefulness of desized concepts and the PPF to represent are useful in many places. Therefore, the proficiency level could be increased focusing on the students with difficulties at directing them for exercises.

Question 2

2. (i) Describe the signaling and rationing functions of market prices. (04 marks)
- (ii) Name **four** major **non-price** determinants of supply for an industrial product. (04 marks)
- (iii) Some of the data relevant for market demand and supply schedules are given below:

Price (Rs.)	Quantity Demanded (Q_d)	Quantity Supplied (Q_s)
4	84	12
8	68	44

Assuming that both demand and supply curves are linear, derive the equations for market demand and supply curves. (04 marks)

- (iv) Compute the equilibrium price and quantity using demand and supply equations. (04 marks)
- (v) Assuming that the government imposes a specific tax of Rs. 3 per unit and compute the price received by the producers after the tax and the tax revenue of the government. (04 marks)

02. (i) - Signalling Function (Information function): Relative prices provide the essential information consumers, producers and resource owners in a market system need in order to decide whether, what, and how much to buy. Markets will function inefficiently if prices signal wrong or misleading information, leading to market failures. **(02 marks)**

- Prices are the market's way of rationing limited resources, goods, and services to those most willing and able to pay for them. The higher the price of anything, the less of it people will be willing and able to buy. Conversely, the lower the price, the more people will be willing and able to buy. When consumers and firms respond to the price signals, scarce resources are rationed between competing uses. Prices are functioning as a locative mechanism. **(02 marks)**

- (ii) - Prices of resource used to produce the product
 - Technology
 - Taxes and subsidies
 - The prices of related goods produced
 - Expectations
 - The number of suppliers **(01 mark each and total marks: 04)**

(iii) - $Q_d = a - bP$ $Q_s = a + bP$
 $Q_d = 100 - 4P$ $Q_s = -20 + 8P$
(02 marks each and total marks: 04)

(iv) - $Q_d = Q_s$
 - $100 - 4P = -20 + 8P$
 - $120 = 12P$
 - $10 = P$ **(02 marks)**

- $Q_d = 100 - 4P$
 - $Q_d = 100 - 4(10) = 60$
 - $Q_d = 60$ **(02 marks)**

(v) $Q_d = Q_s$
 $100 - 4P_b = -20 + 8P_s$

$100 - 4P_b = -20 + 8(P_b - t)$
 $100 - 4P_b = -20 + 8(P_b - 3)$

$100 - 4P_b = -20 + 8P_b - 24$

$100 - 4P_b = -44 + 8P_b$

$100 + 44 = 8P_b + 4P_b$

$144 = 12P_b$

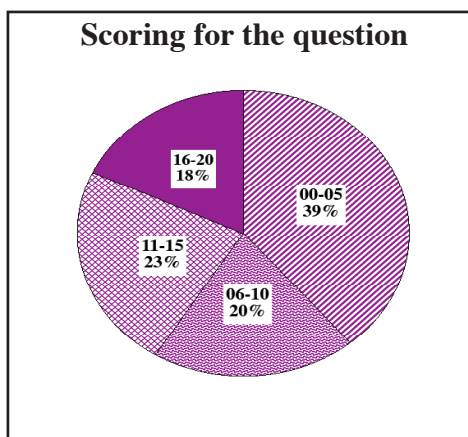
$12 = P_b$

$P_s = P_b - t = 12 - 3$

$P_s = 12 - 3 = 9$ **(02 marks)**

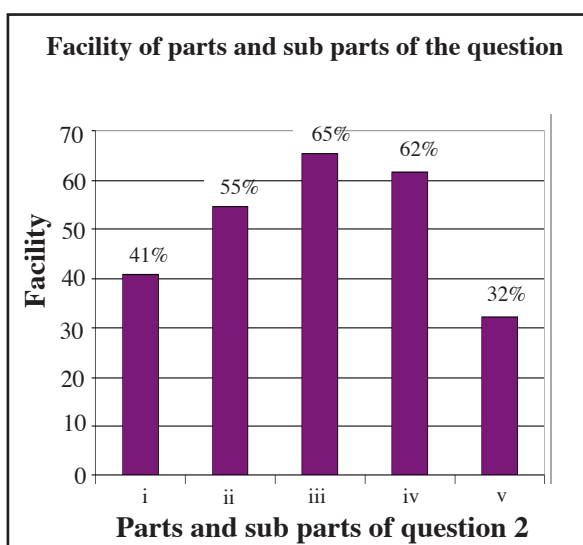
Tax revenue of the government: $3 \times 52 = \text{Rs. } 156$
(02 marks)

Overall observations and conclusions regarding the answers to Question 2 :



Despite question 2 is compulsory only 97% have answered it. The mark allocated for this question is 100. The percentages of candidates scoring within the following four intervals are:

00 - 25	–	33%
26 - 50	–	46%
51 - 75	–	18%
76 - 100	–	3%



This question consisted of 05 sub parts. The lowest facilitation percentage was 32% which was for part v whereas the highest facilitation was for part (iii) which is 65%. The facilitation for parts (ii) and (iv) are 55% and 62% respectively.

- ★ The facility percentage for part i was 41%. This question inquired the function of the market price. The students were unable to explain the signaling function and the rationing function separately. Therefore the knowledge for descriptive explanations, the three functions of the market price that is signaling, rationing and motivation with examples.
- ★ The factors that affect on the supply of industrial goods instead of the supply of the good have been examined by the part ii. The facilitation of this part was 55%. Though some of the students has examined the factors that affect on the supply of a good in general though the non-price factors had been emphasizing questioned, the answer had been presented also with the price. The teaching-learning process should be organized giving much emphasis on the possible differences of the factors affecting the supply accordingly to the nature of the goods.
- ★ The part iii intends the development the demand and the supply equations using the given information. The highest facilitation in question no 02 is indicated by part. It is 65%. It is assumed that the students shows greater skill in formulating equations, drawing graphs and calculations using given information.

- ★ Part iv is related to part ii. That is also a calculation part and the facilitation is 62%. It is recommended to further develop the skills of the students to solve problems using equations which will enable them to earn more marks.
- ★ The lowest facilitation part in this question is part v. It is 32%. Though was able to develop the demand and supply equations, a difficulty in matching taxes to them is shown. There should be much practice on the part of the learner these areas which are not very difficult calculations.

Question 3

3. (i) Explain how the law of diminishing returns and the law of returns to scale affect a firm's cost of production. (04 marks)
- (ii) Discuss whether there is a relationship between the marginal cost curve of the firm and the supply curve of the industry to which it belongs. (04 marks)
- (iii) Explain why a firm under perfect competition faces a horizontal demand curve while the industry faces a downward sloping demand curve. (04 marks)
- (iv) A firm operating in the short period reports that its total revenue is Rs. 100 million, total cost is Rs. 120 million, and total fixed cost is Rs. 40 million. Should the firm stay in business? Why? (04 marks)
- (v) Why is the equality of marginal revenue and marginal cost essential for profit maximization in all market structures? Explain why price (P) can be substituted for marginal revenue (MR) in the $MR = MC$ rule when the firm is operating in a perfectly competitive industry. (04 marks)

Expected answer and the marking scheme

03. (i) - The technology that a firm uses determines its costs.
- According to the law of diminishing marginal returns, as successive units of a variable resource are added to the fixed resources, marginal product and average product rise and marginal cost and average variable cost fall. Then, at the point of maximum marginal product, marginal cost is a minimum. As variable input increases further, marginal product diminishes and marginal cost increases. But average product continues to rise, and average variable cost continues to fall. Then at the point of maximum average product, average variable cost is a minimum. As variable input increases further, average product diminishes and average variable cost increases. (02 marks)
 - In the long run, production is subject to the law of returns to scale. The U-shape of the long run average total cost curve is due to economies and diseconomies of scale.
 - Economies of scale result when increases in output lead to decreases in unit costs and the quantities of all resources are variable.
 - Diseconomies of scale result when increases in output lead to increases in unit costs and the quantities of all resources are variable.

- Constant returns to scale occur when increases in output lead to no changes in unit costs and the quantities of all resources are variable.

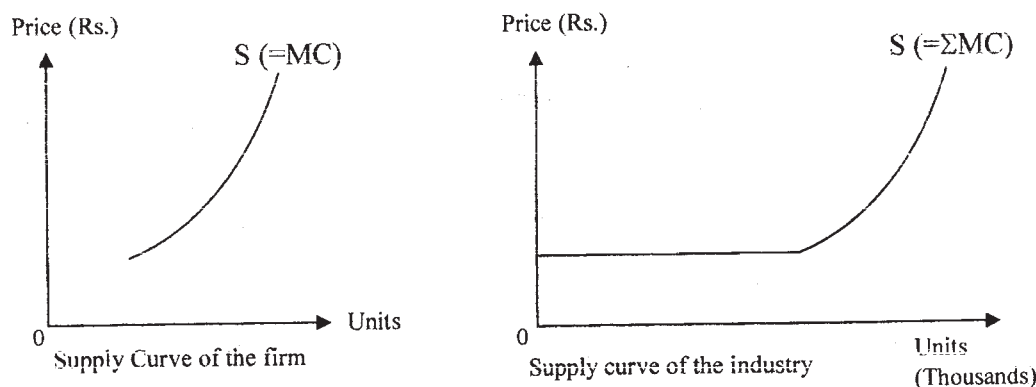
(02 marks)

- (ii) - A perfectly competitive firm supplies the quantity that maximizes profit or minimizes loss. This is done by equating marginal revenue and marginal cost. Therefore, the firm's supply curve is the same as its marginal cost curve above minimum average variable cost (AVC).

(02 marks)

- The industry supply curve shows the quantity supplied by the industry at each price when the plant size of each firm and the number of firms remain constant. The quantity supplied by the industry at a given price is the sum of the quantities supplied by all firms in the industry at that price. Hence, if we sum the marginal cost curves above minimum AVC of individual firms horizontally, we get the industry supply curve.

(02 marks)



- (iii) - In perfect competition a firm is a price-taker. This follows from the fact that the product is homogeneous, it produces a tiny portion of the total output of the particular product and buyers are well informed about the prices of other firms.

- The graphical expression of the demand curve for a firm which is a price-taker, is a horizontal straight line drawn at the going market price. Horizontal demand curve is perfectly elastic. The firm can sell any quantity it chooses at the market price.

(02 marks)

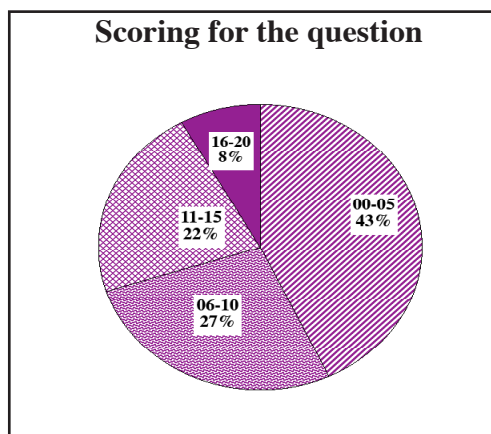
- The industry demand curve is downward-sloping and not perfectly elastic. The product of an individual firm is a perfect substitute for product from any other firm in the industry. Hence, demand is perfectly elastic. But the elasticity of a downward sloping demand curve depends on the substitutability of the particular product for other goods and services.

(02 marks)

- (iv) - The firm should continue to stay in business in the short run. Because if it decides to shut down the plant, the total loss will be equal to the total fixed cost which is Rs. 40 million.

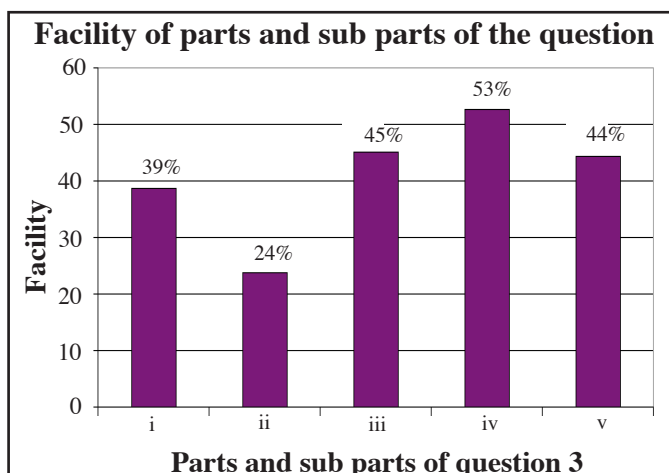
- If it continues to operate the plant total loss will be equal to the difference between total revenue (=Rs. 100 million) and total cost (= Rs. 120 million) which is equal to Rs. 20 million. Therefore, the total loss can be minimized by operating the plant in the short run instead of shutting down. **(04 marks)**
- (v) - If marginal revenue exceeds marginal cost (if $MR > MC$), then the extra revenue from selling one more unit exceeds the extra cost incurred to produce it. The firm makes an economic profit on the marginal unit, so its economic profit increases if output increases.
- If marginal revenue is less than marginal cost (if $MR < MC$), then the extra revenue from selling one more unit is less than the extra cost incurred to produce it. The firm incurs an economic loss on the marginal unit, so its economic profit decreases if output increases and economic profit increases if output decreases.
- If marginal revenue equals marginal cost (if $MR = MC$), economic profit is maximized. **(02 marks)**
- The $MR = MC$ rule can be conveniently restated in a slightly different form when being applied to a perfectly competitive firm. The competitive firm can sell as much as it chooses at the prevailing market price. It faces a perfectly elastic demand curve. The result is that product price and marginal revenue are equal, that is, each extra unit sold adds precisely its price to total revenue. Thus under perfect competition, we may substitute price for marginal revenue in the $MR = MC$ rule. **(02 marks)**

Overall observations and conclusions regarding the answers to Question 3 :



answered it. The total mark for the question is 100. The percentages scoring in the respective four ranges are:

00 - 25	–	49%
26 - 50	–	34%
51 - 75	–	14%
76 - 100	–	3%



This question consist of 05 parts. The question with the lowest facility percentage was for part (ii) which is 24%. The part with highest facilitation is (iv) for which the percentage was 53%.

- ★ The facilitation for part I is 39%. This question has investigated how the diminishing returns law and the and returns to scale concept affect on the production cost. There has been a weakness in answering this question due to the inability to correctly understand the relationship between the short run and long run in the production theory and also the relationship between the productivity and costs. Specially it is recommended that the relationship between the productivity and cost should be emphasized using production and cost curves.
- ★ The part ii is the least facilitation part in the question 02. It is 24 in percentage. It shows that the student has not been able to correctly understand this question which investigates the marginal cost of a firm and the supply curve of the industry. There had been a failure in understanding supply curve of a firm and variable costs through the difference between the firm and the industry had been identified. At the same time, knowledge should be imparted so that so that the supply curve of a company which rests below the minimum general variable cost is similar to the firm's supply curve and that the industry supply curve is the horizontal summation of the supply curves of individual firms.
- ★ Facilitation for part ii is 45%. This question measures the understanding between the supply curve of the industry and the supply curve of the firm in a perfectly competitive industry. Though the shape of the supply curve of a firm and the reasons for that had been known, the difficulty had been because of the supply curve of an industry and the reasons for that are unknown. As in the previous part (i.e. part ii) presenting the relationship among the firm and the industry and the market in teaching, these weakness could be minimized.

- ★ Part iv) has the highest facility percentage from this question which was 53%. A mathematical answer was expected from this part. This is the part which has been the most successful within the question. The mistakes can be easily overcome by training the students on the calculation on the profit, loss, cost and revenue.
- ★ Facilitation of the part v) was 44%. This question examines the concepts behind equating marginal revenue and marginal costs to calculate the profit maximizing point and the reason for the condition $MC=P$ for perfectly competitive firms. In most of the cases, the first part is answered by the students but the proceeding questions are being neglected which may be the reason behind the low marks earned by the students although the calculations are easy. Keeping the students involved in exercises of answering the questions could be supported to rectify these weaknesses.

Question 4

4. (i) What do you mean by changes in inventory? Why are changes in inventories included as part of investment spending? (04 marks)
- (ii) Why are interest payments by the government considered part of personal income but **not** part of national income? (04 marks)
- (iii) "A country that spends more than its total national income must have a deficit in the trade balance." Comment on this statement. (04 marks)
- (iv) You are given the following information about the economy. (in million Rs.)
- | | |
|------------------------------|---------|
| National income (Y) | = 5,200 |
| Disposable income (Y_d) | = 4,400 |
| Consumption (C) | = 4,100 |
| Budget deficit (BD) | = 150 |
| Deficit in the trade balance | = 110 |
- Calculate the
- (a) value of government purchases (G)
- (b) saving (S)
- (c) investment (I) (04 marks)
- from the above information.
- (v) What is the 'underground economy'? How might its size be reduced? (04 marks)

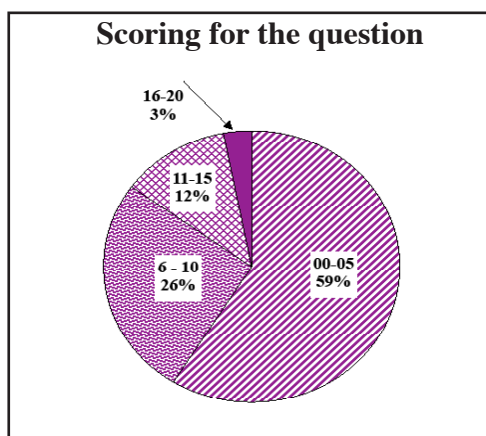
Expected answer and the marking scheme

04. (i) - Inventories consist of (a) stocks of materials that firms hold for use in further production, (b) stocks of semi-finished goods in the process of production and (c) stocks of finished goods ready for sale but not yet sold.
- Changes in inventories refer to the change in the market value of these items at the end of the year and the beginning of the year.
- Changes in inventory can be planned or unplanned. Inventories of output allow firms to meet orders in spite of temporary fluctuations in the rate of output or sales. (02 marks)

- If stocks held at the end of the year exceed those held at the beginning of the year, we say there has been a stock accumulation or positive investment in stocks and it is counted as current investment because it represents goods produced (even if only half-finished) but not used for current consumption.
 - GDP is designed to measure total current output. Therefore, we must certainly make an effort to include in GDP any products which are produced but **not sold this year**. If GDP is to be an accurate measure of total production, it must include the market value of any additions to inventories which accrue during the year. In the expenditure approach to GDP, we include change in inventories as a component in investment spending. **(02 marks)**
- (ii) - Interest payments on government debt are considered as transfer payments for the purpose of national accounting. GDP includes only spending on goods and services and excludes transfer payments. **(02 marks)**
- This is a return on debt incurred to pay for past government programmes and is not a payment for current government goods and services. Therefore, the interests are excluded from GDP calculations. However, interest incomes received from the government are included in the calculation of personal income. **(02 marks)**
- (iii) - National income is defined as $Y = E (= C + I + G + NX)$ **(02 marks)**
- If the spending on consumption, investment and government purchases is greater than national income, then net exports must be negative.
 - $Y < (C + I + G)$, then the trade deficit $(X - M)$ must be negative. **(02 marks)**
- (iv) (a) Government purchases (G):
 $Taxes (T) = Y - Y_d = 5200 - 4400 = 800$
 $Budget\ deficit (G - T) = 150$
 $G - T = 150$
 $G - 800 = 150$
 $Therefore, G = 150 + 800 = 950$ **(02 marks)**
- (b) Saving (S):
 $Saving = Disposable\ Income (Y_d) - Private\ consumption (C)$
 $S = Y_d - C$
 $S = 4400 - 4100 = 300$ **(01 mark)**
- (c) Investment (I):
 $Y = C + I + G + NX$
 $5200 = 4100 + I + 950 + (-110)$
 $I = 5200 - 4940 = 260$ **(01 mark)**

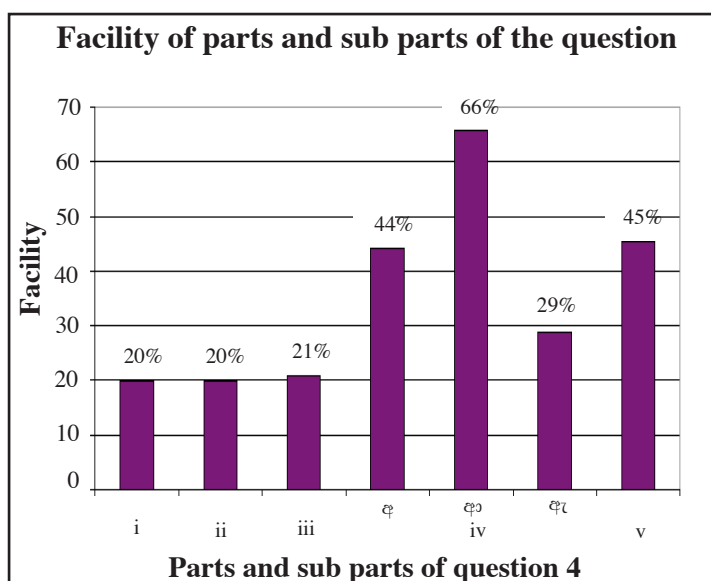
- (v) - The *underground economy* consists of economic activity that avoid Official detection and measurement. The activities are either inherently illegal or not reported to avoid taxes, or detection by the authorities, or for other reasons. **(01 mark)**
- Examples of the former include illegal drug trafficking, bookmaking, and prostitution. Examples of the latter include the non declaration of receipts by owners or managers of restaurants, bars and various retail establishments, the failure to report incomes of tips, casual or part-time work, particularly by people who would lose such benefits as welfare payments (Samurdhi). **(01 mark)**
 - Reduction of tax rates
 - Making the tax system more equitable
 - Devoting more resources to law enforcement
 - Increasing the penalties for participating in the underground economy. **(01 mark each for any two reasons)**

Overall observations and conclusions regarding the answers to Question 4 :



Notwithstanding that question 4 is compulsory, the percentage answering it is 36%. The question carries 20 marks. The percentages scoring within the following four intervals are:

00 - 05	–	59%
06 - 10	–	26%
11 - 15	–	12%
16 - 20	–	3%



This question consists of 7 subparts. Parts (i) and (ii) records the lowest facilitation which is 20%. The highest facilitation is recorded for part (iv) (a) which is 66%.

- ★ Part (i) was directed to test the knowledge on definitions and factors of change in stocks as a component of investment expenditure. The facilitation of this was 20%. Candidates have been unable to identify that change in stock is the difference between the value of stocks at the beginning of the year and the year end and consists the value of raw materials, processing stocks and finished goods stocks. It should also be stressed that change in stocks should be accounted as an investment expenditure since gross domestic product is inclusive of all productive manufactures and that gross domestic product is under-valued due to left-over stocks out of the finished goods.
- ★ Facility percentage of part (ii) was 20%. Majority of the candidates have not identified that interest paid for government loans are considered as an expenditure in the form of a transfer. It is also important to educate the student to exclude the interest paid for government loans when the total product is calculated since it is not an expenditure borne to purchase the total product of the respective year.
- ★ Part (iii) also records a lower facility percentage which is 21%. This was directed to test the ability of the candidates to explain using the symbols in national accounting that if a country is having a higher expenditure than its national income, the excess expenditure is equal to the balance of the trade account. Majority has been unable to explain that trade balance is equal to the net exports and when the national expenditure is higher than the national income, the net exports should take a negative figure.

- ★ Part (iv) was focused on calculating the national accounting figures using a given set of data. It consisted of 3 sub-parts which recorded different levels of facilitation.
 - a) Facility percentage was 44%. Tested the ability of calculating the government purchases using budget deficit and tax income calculated using a given set of data. A difficulty of 56% was noticed.
 - b) Facility percentage was 66%. The majority has been able to calculate the savings using the difference between disposable income and consumption.
 - c) Facility percentage was 29%. Although the question was directed to calculate the value of various components of national accounting using the equilibrium condition, a difficulty level of 71% was recorded for this part. Thus, it is suggested to develop the skills in calculating various concepts related to national accounting using a give set of data.
- ★ Facility percentage of Part v was 45%. Especially it is important to define the term “Hidden Economy”, explain the economic activities that falls under that concept using examples and to explain that people’s attitudes and legal framework of the economy may effect this. It is also essential to educate about the plausible steps that can be taken from a government to minimize or eliminate such type of activities.

Question 5

5. (i) Briefly explain the meaning of the ‘investment multiplier’. (04 marks)
- (ii) Distinguish between ‘inflationary gap’ and ‘recessionary gap’. (04 marks)
- (iii) “The simple income-expenditure model of income determination shows that the economy can be in equilibrium with **either** inflation or unemployment **or** neither”. Explain using appropriate diagrams. (04 marks)
- (iv) Suppose that for a particular closed economy, for some given time period, investment was equal to 100, government purchases were equal to 75, net taxes were fixed at 100, and consumption (C) given by the consumption function,

$$C = 25 + 0.8 Y_d$$
 where Y_d is disposable income.
 - (a) What are the values of the government expenditure multiplier and the tax multiplier? (04 marks)
 - (b) Suppose that the full-employment level of income for this economy is 1,000. What would be the increase in government spending required to reach full-employment income level? Alternatively, what reduction in tax collection would be sufficient to reach full-employment income level? (04 marks)

Expected answer and the marking scheme

05. (i) - Investment has a multiplier effect on output. When investment changes, output will at first rise by an equal amount. But as the income receivers in the capital-goods industries get more income, they set into motion a whole chain of additional secondary consumption spending. This surprising result is called multiplier effect or, more simply the *multiplier*. (02 marks)

- Investment multiplier is defined as the *ratio* of the change in national income to initial change in planned investment expenditure which causes that change in real output.

Investment multiplier (k) = Change in real GDP (ΔY) /Initial
change in investment (ΔI)

$$k = \Delta Y / \Delta I \quad (01 \text{ mark})$$

- The size of the multiplier depends upon how large the marginal propensity to consume (MPC) is. It can also be expressed in terms of marginal propensity to save (MPS). The investment multiplier formula is:

$$K = 1/ 1-MPC \quad \text{or} \quad k = 1/MPS$$

(01 mark)

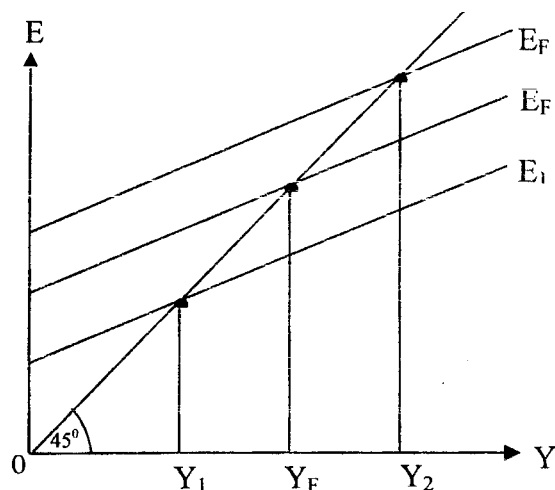
- (ii) - Inflationary gap is the amount by which an economy's aggregate expenditures *at the full-employment GDP* exceed those just necessary to Achieve the full-employment GDP. **(01 mark)**

- The recessionary gap is the amount by which aggregate expenditures *at the full-employment GDP* fall short of those required to achieve the full-employment GDP. **(01 mark)**

- The effect of the inflationary gap – excessive spending – is that it will pull up output prices. Since business cannot respond to excessive spending by expanding their real output, demand-pull inflation will occur. Nominal GDP will rise because of higher price level, but real GDP will not. **(01 mark)**

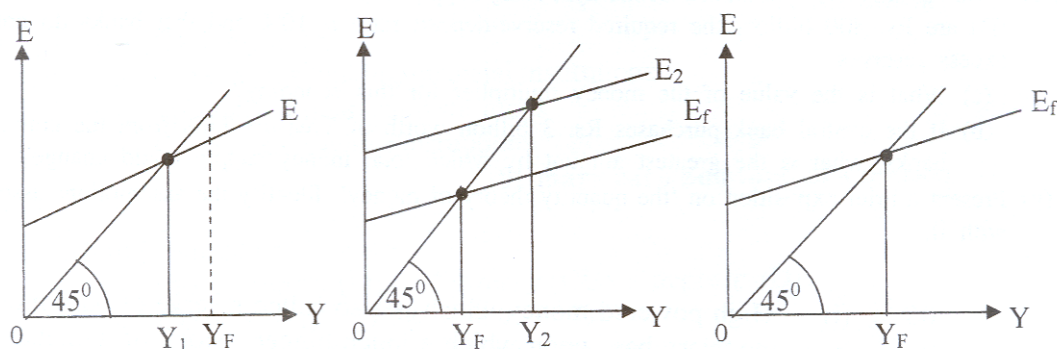
- The effect of recessionary gap – deficiency of spending – is that it will contract or depress the economy resulting unemployment and fal in ral output. **(01 mark)**

- National income is said to be in equilibrium when there is no tendency for it either to increase or to decrease. The particular value of national income that exists in equilibrium is called the *equilibrium national income*. The requirement that must hold if equilibrium to be established takes two alternative forms: (a) desired spending equals actual output, $Y = E$ (the income-expenditure method) (b) leakages equal injections, $W = J$ (the leakages-injections method). When this equilibrium condition is satisfied, economy can be in equilibrium with either inflation or unemployment or neither as shown below: **(01 mark)**



- (iii) - National income is said to be in equilibrium when there is no tendency for it either to increase or to decrease. The particular value of national income that exists in equilibrium is called the *equilibrium national income*. The requirement that must hold if equilibrium to be established takes two alternative forms: (a) desired spending equals actual output, $Y = E$ (the income-expenditure method) (b) leakages equal injections, $W = J$ (the leakages-injections method). When this equilibrium condition is satisfied, economy can be in equilibrium with either inflation or unemployment or neither as shown below:

(01 mark)



Y_F = Full employment income level

(01 mark each for three equilibrium situations)

- (iv) (a) - Government spending multiplier: $K_G = 1/(1 - MPC)$ (01 mark)

- $K_G = 1/(1 - 0.8) = 1/0.2 = 5$ (01 mark)

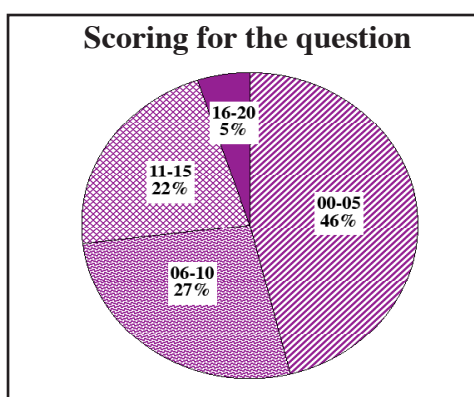
- Tax multiplier: $K_T = MPC/(1 - MPC)$ (01 mark)

- $K_T = 0.8/(1 - 0.8) = 0.8/0.2 = 4$ (01 mark)

- (b) - Current equilibrium level of income: $Y = C + I + G$

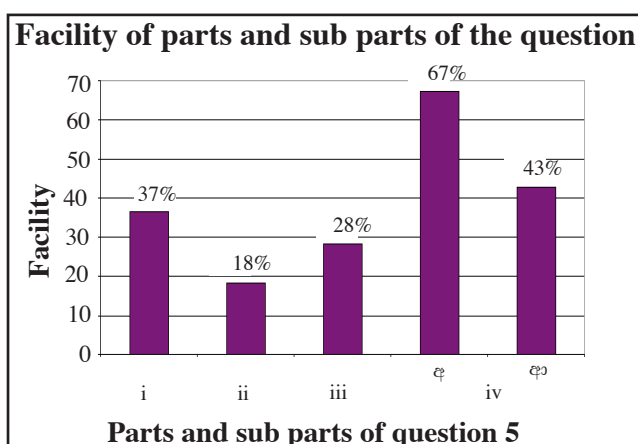
- $Y = 25 + 0.8(Y - 100) + 100 + 75$
- $Y = 25 + 0.8Y - 80 + 175$
- $Y = 0.8Y + 120$
- $Y - 0.8Y = 120$
- $0.2Y = 120$
- $Y = 600$
- Output Gap = Full employment Income level - Current Income level
- $= 1000 - 600 = 400$
- Government spending required to reach full employment:
- Output Gap / Government spending Multiplier (K_G) = $400 / 5 = 80$ **(02 marks)**
- Reduction of tax collection to reach full employment:
- Output Gap / Tax Multiplier (K_T) = $400 / 4 = 100$ **(02 marks)**

Overall observations and conclusions regarding the answers to Question 5 :



The question carries 20 marks. The percentages scoring within the following four intervals are:

00 - 05	–	46%
06 - 10	–	27%
11 - 15	–	22%
16 - 20	–	5%



This question include 4 parts and section iv is divided into sub part (a) and (b). Highest facilitation of this question is iv a and it has 67% facilitation.

Lowest facifitation is part II and 18% is the facifitation of it.

- ★ The facility percentage for part (i) is 37%. The question was directed to test the knowledge on the multiplier effect on investment expenditure. The multiplier effect takes place in several rounds and that investment multiplier can be calculated using the percentage difference between the ratio of the real production and investment expenditure. Additionally, it was noticed that students were unable to decide that the value of the multiplier depends on the marginal propensity to save (in the marginal withdrawal ratio) and thus the teaching-learning system should be developed to enhance this knowledge.
- ★ The facility percentage for part (ii) is 18% and is the hardest part in question no 05. The knowledge in depicting this relationship using a diagram ($Y=E$) should be enhanced to test the inflation and deflation gap arises due to the difference between the full employment level of output and the aggregate expenditure (demand). The knowledge in depicting this relationship using a diagram ($Y=E$) of the candidates should be enhanced.
- ★ The facility percentage for part (iii) is 28%. The question was to test the two approaches of calculating the equilibrium output, i.e. using the Income=Expenditure approach and Withdrawals=Injections approach. It should be made aware that if the equilibrium level of output is higher than the full employment level it may cause an inflationary effect where if it is lower than the full employment level it will cause an unemployment situation. When the aggregate demand is equal to the expected production level it will not cause an inflationary situation or an unemployment situation. It is suggested that students should be taught to display these relationship using $Y=E$ diagram.
- ★ Part (iv) consists of two subparts as a and b where the facility percentage of part a is 67%. It was directed to test the skill of calculating the government spending multiplier and the tax multiplier using given set of macroeconomic data. It is noted that the majority of the candidates have had the skill on the above area and suggested to further improve that skill.

The facility percentage of part b is 43% where the question was directed to test to what extent that increase in government expenditure or reduction in the tax is needed to achieve the full employment output level. Therefore, students should be made aware about how to calculate output gap, expenditure multiplier and tax multiplier in order to determine the above mentioned aspect.

Question 6

Sub Section B

(Select minimum of two questions from this section.)

6. (i) What do you mean by 'high powered money'? Explain briefly how high powered money may be created by a central bank. (04 marks)
- (ii) What are the determinants of money supply in an economy? (04 marks)
- (iii) What are the major categories of financial institutions that make up the Sri Lanka's financial system? (04 marks)
- (iv) Assume that for a hypothetical economy, money supply (M) is Rs. 1,200 billion, total bank deposits (D) are Rs. 800 billion, the required reserve-deposit ratio is 10% and that banks do not hold excess reserves.
 - (a) What is the value of the money multiplier for this economy?
 - (b) If the central bank purchases Rs. 3 billion worth of Treasury bills from the commercial banks, what is the greatest amount by which total money supply could change? (04 marks)
- (v) Present a brief exposition on 'the quantity theory of money'. Identify the assumptions associated with it. (04 marks)

Expected answer and the marking scheme

06. (i) - High powered money which is also called reserve or base money is the monetary base upon which a much bigger stock of monetary assets is built. It is one of the principle determinants of the nation's money supply. Money supply is always some multiple of the high powered money. $M = mH$, where M is the money supply, m is the money multiplier and H is high powered money. **(01 mark)**
- High powered money consists of (a) currency held by the public and the commercial banks and (b) deposits held by the commercial banks with the Central Bank. **(01 mark)**
 - There are two channels of releasing high powered money from the Central Bank to the economy. One is acquiring domestic assets through lending to the government and/or commercial banks. Borrowing from the Central Bank activates the outflow of currency notes and coins from Central Bank vaults. Once the government uses them for payments with respect to its expenses, they become assets of the general public and the banking system. Similarly, high powered money expands when commercial banks borrow from the Central Bank or sell domestic assets in their portfolio such as treasury bills to the Central Bank. **(01 mark)**
 - The other channel is the Central Bank transactions in the foreign exchange market. When the Central Bank purchases foreign exchange from the government or commercial banks it pays in rupee currency notes and coins expanding high powered money. **(01 mark)**
- (ii) Determinants of money supply:
- (a) Factors affecting high powered money :
- Lending to the government by the Central Bank
 - Lending to the commercial banks by the Central Bank
 - Repo and reverse repo agreements with commercial banks
 - Buying and selling of foreign exchange by the Central Bank (External assets)
 - Other net assets of the Central Bank
 - Transfer of Central Bank's profit to the government
- (b) Factors affecting the size of the money multiplier:
- People's preference to use currency for transactions (currency-Deposit ration)
 - Statutory reserve ratio
 - Excess reserves
- (02 marks)**
- (iii)
- Banking sector
 - Other deposit taking financial institutions
 - Specialized financial institutions
 - Contractual savings institutions
- (01 mark each and total of 4 marks)**

(iv) (a) Money multiplier:

- Money supply (M) = Currency (CU) + deposits (D)
- $CU = M - D = 1200 - 800 = 400$
- If banks do not hold excess reserves, then
Reserve assets (R) = $(0.1)D = (0.1)800 = 80$ and
High powered money (H) = $CU + R = 400 + 80 = 480$
- Money multiplier: $M/H = m = 1200/480 = 2.5$ (02 marks)

(b) If the Central Bank purchases Rs. 3 billion worth of Treasury Bills, from the commercial banks, then the maximum increase in money supply is Rs. 7.5 billion

- Because $\Delta M = m(\Delta H) = 2.5 (3) = \text{Rs. 7.5 billion}$ (02 marks)

(v) - The Quantity Theory of Money predicts that the general price level is *positively related* to the quantity of money in such a way that changes in the quantity of money cause proportionate

changes in the price level. Thus, for example, a doubling of the quantity of money would lead to a doubling of the price level.

(02 marks)

- The quantity theory of money uses the so-called 'equation of exchange' to relate changes in money supply to changes in price level. The equation of exchange can be written as follows:

$$MV = PY$$

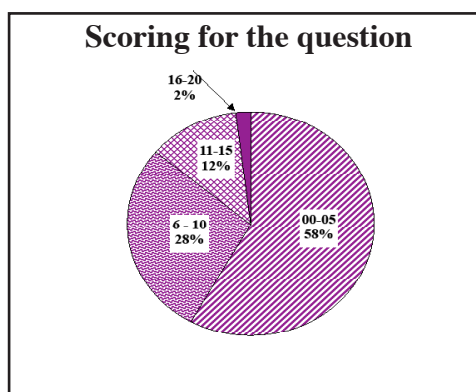
- Although, this is called an equation, it is in fact a definitional identity, which means something which is true simply by virtue of how the terms are defined. However, this equation can be transformed into a theory of price determination (Quantity theory of money) by making certain assumptions regarding the behaviour of some variables in the equation. Two assumptions are made:

- i. The velocity of money (V) is relatively stable
- ii. Physical volume of output (Y) is fixed as the economy is at full employment.

When V and Y variables in the equation of exchange are fixed, there will be a direct positive relation ship between M and P.

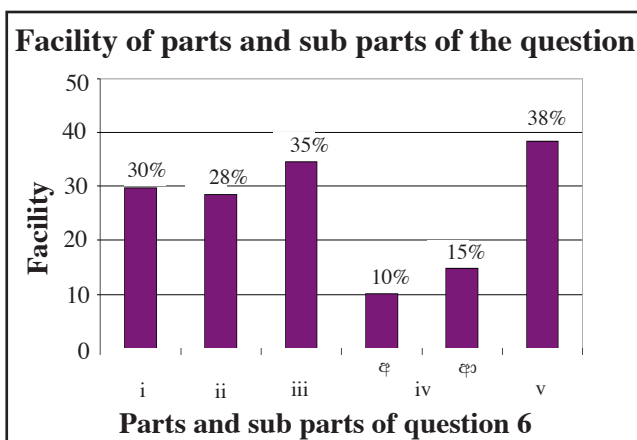
(01 mark each for the assumptions and total of 02 marks)

Overall observations and conclusions regarding the answers to Question 6 :



About 69% have selected question 6. The question carries 20 marks. Given below are the percentages scoring within the four selected intervals:

00 - 05	–	58%
06 - 10	–	28%
11 - 15	–	12%
16 - 20	–	2%



This question comprises 5 parts and part (iv) comprises two sub parts. part (v) has maximum facilitation but it is limited 38%. Lowest facilitation has part (iv) (a) and it is 10% only. part (b) has next lowest facilitation of sub part. it is 15% facilitation of other 3 parts is between 28%-35% and it is varied.

- ★ Part I - Aimed at testing the knowledge of the candidates on defining the high powered money and how the central bank creates high powered money. The facility percentage was 30%. Although the students were able to define the composition of high powered money, they are not that familiar with how banks create money. The teaching-learning system should be organized to teach the money creation process and the functions of a central bank.
- ★ Part II - The facility percentage of this question is 28% where it was directed to test the knowledge on determinants of the money supply of an economy. Although the candidates could have answered by having a basic knowledge on the determinants of the money supply, the facilitation was very low due to the fact of having a low level of subject knowledge in this area.
- ★ Part III - This question recorded a higher facility percentage which was 35%. It is noted that success rate can be increased by referring to past paper questions since similar type of questions were included in the previous years.

- ★ Part IV - This consisted of two parts as a and b and records the lowest facility percentage

It is clear that, although the students are able to calculate the money creation using given data, the concept of money multiplier is new to them.

It is also noted that although the candidates have the knowledge on expansionary effect of increased money deposits, the knowledge on the expansionary effect of a purchase of treasury bonds from the commercial banks is not sufficient. Thus, the candidates should be engaged in exercises which will enhance the knowledge on the effect of purchase and repurchase activities of treasury bills on the money supply.

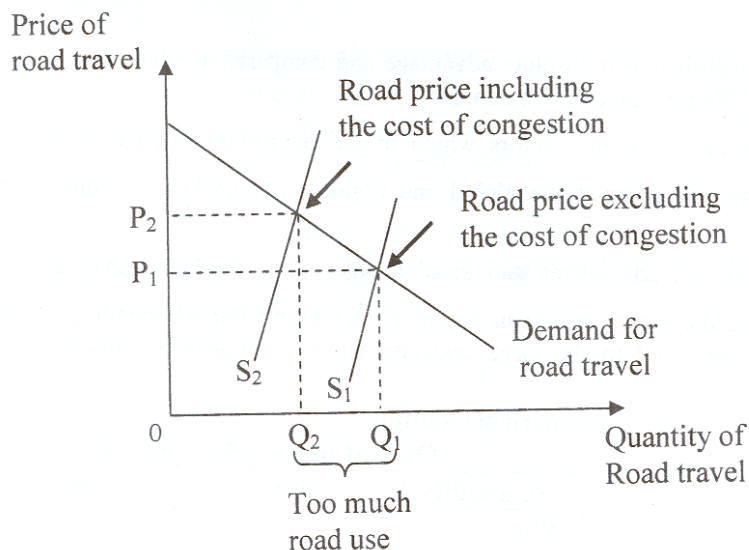
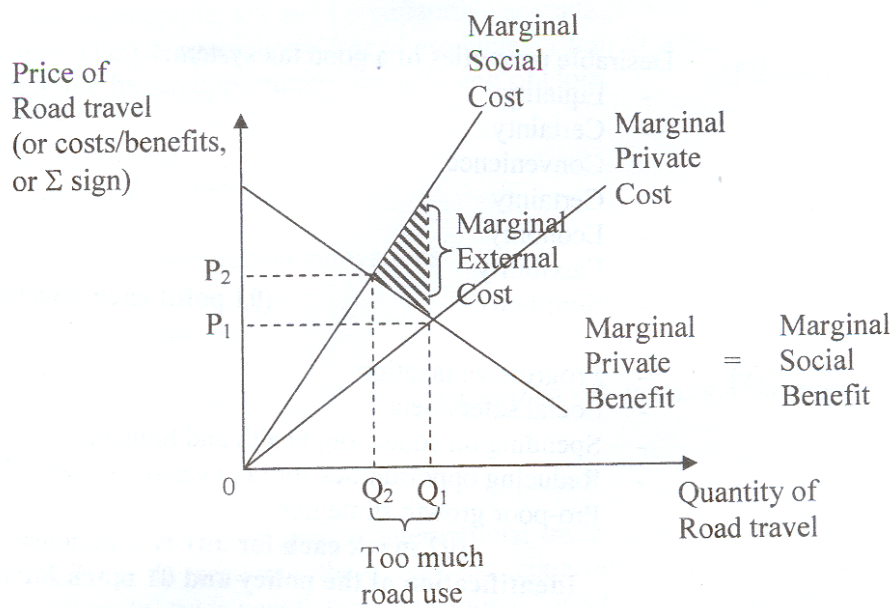
- ★ It is also clear that, although the candidates have the knowledge in expansionary effect of increase in money deposits, the knowledge in the expansionary effect on the money supply as result of purchasing of treasury bonds by the Central Bank and commercial banks is not sufficient. Thus, the candidates should be engaged in exercises which will enhance the knowledge on the effect of purchase and repurchase activities of treasury bills on the money supply by the Central Bank and commercial banks.
- ★ Part V - This records the highest facilitation among the parts of the question which is 38%. The question is not a complex one and can be answered with basic knowledge on economics. It is highlighted that the candidates have not paid their attention on the subject matters. It is suggested to organize the class room teaching activities which will direct the students to more exercises.

Question 7

7. (i) Why might market fail to allocate resources in an efficient manner? (04 marks)
- (ii) With the help of an appropriate diagram, explain why there are too many motorists than socially desired in Sri Lankan roads. (04 marks)
- (iii) Why is a role for government inevitable in a market economy? (04 marks)
- (iv) Outline the desirable properties of a good tax system. (04 marks)
- (v) Explain the ways in which fiscal policy can reduce income inequality. (04 marks)

Expected answer and the marking scheme

07. (i) Reasons for market failure:
 - Market power
 - Non provision of public goods
 - Existence of externalities in production and consumption
 - Over-use of common resources
 - Imperfect information
 - Factor immobility
 - Missing markets
 - Unequal income distribution **(01 mark each for any four reasons)**
- (ii) - This is a case of negative externality in consumption. The motorists who use public roads frequently cause traffic congestions which are considered as external costs in consumption. As it is an external cost, the private vehicle owners do not take this into account when they make consumption (driving) decisions. The consumption decisions based on private benefits and failing to consider external costs, would lead to a socially undesirable level of consumption (over- consumption). **(02 Marks)**



(iii) The role of government:

- To protect life and property by exercising a monopoly of force and establishing property rights
 - To improve economic efficiency by addressing the various causes of market failure
 - To protect the environment including assessing the possibility of human-caused climate change and dealing with its consequences.
 - To achieve some accepted standard of equity.
-
- To influence the rate of economic growth
 - To stabilize the economy against income and price level fluctuations.
- (01 mark each for any four reasons)

(iv) Desirable properties of a good tax system:

- Equality
- Certainty
- Convenience
- Certainty
- Economy
- Flexibility
- Simplicity

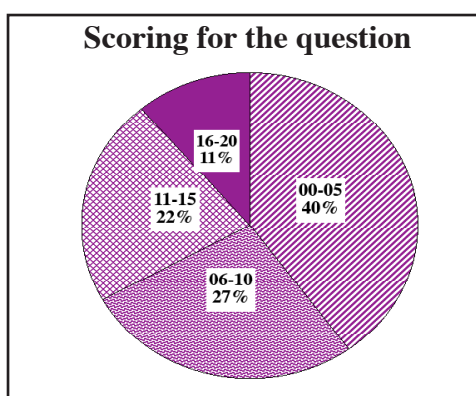
(01 point each and total of 4 marks)

(v)

- Progressive taxation
- Social safety nets
- Spending on education, health and housing
- Reducing opportunities for tax evasion and avoidance
- Pro-poor growth strategies

(02 mark each for any two policies: 01 mark for the Identification of the policy and 01 mark for the explanation)

Overall observations and conclusions regarding the answers to Question 7 :



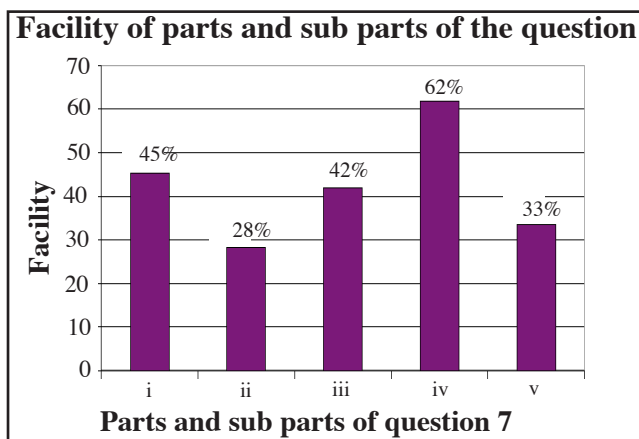
Majority of the candidates have chosen this question for which the percentage is 85%. (refer the graph no 1.2.3) A total of 20 marks is allocated for this question.

00 - 05 – 40%

06 - 10 – 27%

11 - 15 – 22%

16 - 20 – 11%



This question consist of 5 subparts of which the part (iv) has been recorded as the easiest question among the rest where the facility percentage was 62%. The lowest facility percentage is for part (ii) which is 28%. The facilitation of parts (i), (iii) and (v) are 45%, 42% and 33% respectively.

- ★ The facility percentage for part i is 45%. The aim of the question was to test the knowledge of the candidates on the forms of market failure due to inefficient resource allocation. This question is not a difficult one and can be answered by having a general knowledge on the subject matter. Self-learning skills of the candidates should be developed.
- ★ Facilitation for part ii is 28% which records the lowest facilitation among the parts of this question. The question tests the practical applications of the theoretical knowledge. Accordingly, the candidates have failed to apply the theories learnt in practical application leading to the lowest facilitation. Hence, it is important to incorporate the practical application of various theoretical areas in teaching, learning system.
- ★ Facility percentage of part iii is 42%. This is not a question having difficult issues. Thus the candidates having an organized way of learning could have answered using the memory. The class room activities should be organized to refresh the knowledge of the students in these areas very often.
- ★ Part iv records the highest facility percentage in this question which is 62%. Although it is a question which could be answered using the fundamentals of the subject, the fact that the considerable percentage failing depicts that the subject knowledge of the candidates in this area is not sufficient. The teaching-learning system should be organized to update the knowledge regularly.
- ★ Part v records the lowest facilitation which is 33%. It was directed to test the knowledge on reducing the income inequality through government monetary policies, which is considered to be answered by memory. However, due to the lack of ability of the students to identify the government monetary policy has caused this lower facilitation. The teaching-learning system should be organized to demonstrate the government monetary policy and its uses.

Question 8

8. (i) Distinguish between absolute advantage and comparative advantage in production. Illustrate your answer giving numerical examples. (04 marks)
- (ii) Explain the economic factors which might determine patterns of trade between countries. (04 marks)
- (iii) Compare and contrast the global and regional approaches to reducing barriers to international trade. (04 marks)
- (iv) What are the advantages and disadvantages of a flexible exchange rate system? (04 marks)
- (v) Examine the recent trends in export earnings and import spending of Sri Lanka. What factors have contributed to the large trade deficit in Sri Lanka at present? (04 marks)

Expected answer and the marking scheme

8. (i) - Numerical example :

output per worker per day		
Commodity	US	India
Wheat	8	4
Cloth	4	3

- One country is said to have absolute advantage over the second country in production of a commodity, say wheat, if the first country can produce more wheat using a given quantity of inputs than can the other.
- In the example given above, the United States has an absolute advantage greater productivity – in producing both wheat and cloth. One worker can produce more of either goods in the US than in India. (02 marks)
- One country has a comparative advantage over another in the production of one commodity if its opportunity cost of producing that commodity is less than another's.

- (ii) - Factor abundance
 - Productivity differences
 - Economies of scale
 - Technological changes and innovations
 - Location
 - Product life cycles
 - Government policies **(01 mark each for any 4 factors)**

(iii) - Since World War II, barriers to international trade have been reduced significantly. In reducing these barriers, countries have taken two approaches: (a) trade negotiations on a global basis and (b) formation of regional trading blocks.

- Since WWII, eight rounds of international trade negotiations have been conducted under GATT (General Agreement on Tariffs and Trade). Each of these rounds resulted in reductions in tariff rates. The Uruguay Round negotiations started in 1986 and concluded in 1993. It was more comprehensive than past agreements and covers trade in services as well as trade in goods. It also covers trade-related intellectual property rights and trade-related investment. Under this agreement many tariff and non tariff barriers will be reduced or eliminated.
- Rather than relying entirely on the global approach, many countries have formed regional trading blocks. They have agreed to reduce or eliminate trade barriers among themselves while maintaining barriers against countries outside the block. i.e. North American free Trade Area (NAFTA), The European union (EU), SAPTA.
- Formation of regional trading agreements are relatively easy as compared to global agreements which take many years to reach an agreement. It is easier for a small group of neighbouring countries to with similar concerns and cultures to agree on market opening in particular area than to reach agreement in a wider forum such as WTO
- They can also offer new approaches to rule-making and so act as stepping stones to a global level agreements.
- Regional agreement make it harder for countries outside the region to trade with those inside and may discourage further opening up of markets, ultimately limiting growth prospects for all. Moreover broad based multilateral agreements with more players and more sectors, will offer greater potential for mutual gain than limited bilateral or regional deals.

(04 marks)

(iv) Advantages:

As there is an automatic adjustment mechanism in balance of payments under a freely fluctuating exchange rate system, the authorities can pursue independent domestic policies to achieve internal economic objectives; Monetary policy can be completely independent of external influences.

- Country has no need to hold large official reserves of foreign currencies; resources which would be otherwise tied up in the reserves can be used more productively elsewhere.
- Correctly valued exchange rates are necessary if the world resources are to be efficiently allocated between competing uses.

(01 mark each for any two reasons)

Disadvantages

- Floating exchange rates increase business uncertainty and lead to less specialization, trade and investment than would otherwise take place.

- Floating exchange rate promotes an increase in currency speculation with all its destabilizing effects.
- In a floating exchange rate system, no such discipline exists to make a country to reduce its inflation rate.

(01 mark each for any two reasons)

(v)	Year	Cost of Imports (\$ million)	Export Earnings (\$ million)
	2008	14,091	8111
	2009	10,207	7085
	2010	13,451	8626
	2011	20,296	10,559
	2012	19,183	9773

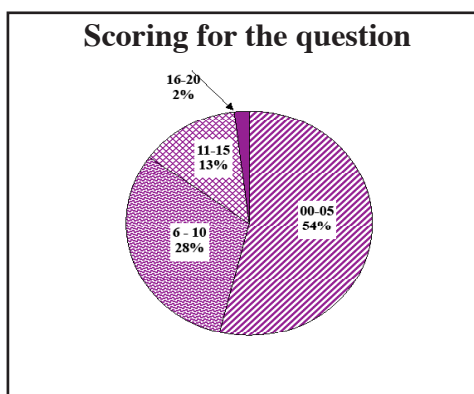
(Correct data for at least one year: Imports – 01 mark; Exports 01 mark)

There are several reasons for the large deficit in trade balance.

- The slow growth in export earning as compared to the rapid increase in the cost of imports. In 2011, cost of imports increased by 51% as compared to 2010, but export earnings increased only by 22%.
- The demand for Sri Lankan exports has been discouraged mainly due global recession.
- One of the main reasons for the rapid increase in the cost of imports was the increase in the volume of imported capital goods owing to heavy public investment programmer on infrastructure development.
- Maintenance of an overvalued exchange rate.
- The sluggish growth is export earnings is partly due to the lack of diversification in the country's export structure.

(01 mark each for any two reasons; total marks:02)

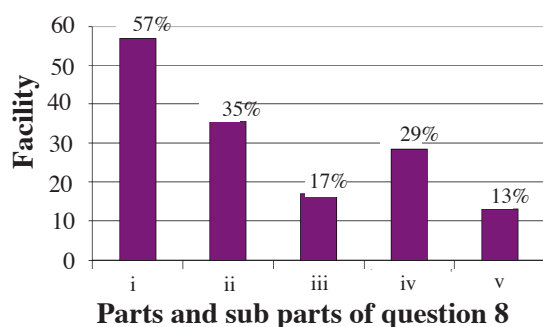
Overall observations and conclusions regarding the answers to Question 8 :



44% of the candidates have chosen this question (Refer the graph no 1.2.3) for which a total of 20 marks is being allocated of which selected intervals:

54% , 28%, 13%, and 02% of the candidates have earned marks between the range of 0-5 marks, 6-10 marks, 11-15 marks and 16-20 marks respectively.

Facility of parts and sub parts of the question



This question consists of 5 sub parts of which the part (i) has been the easiest question among the rest of which the facility percentage was 57%. Part (v) records the lowest facilitation which was 13%. Part (iii) records a facility percentage of 17%.

- ★ The facility percentage of part i is 57% through which the ability to analyze the absolute and comparative advantage using examples was tested. It is noted that 43% of the candidates did not have the required skill, hence failed to answer this question correctly. Thus is suggested to organize the teaching-learning system to improve the skills of the students to especially increase the ability to analyze the absolute and comparative advantage in production using numeric examples.
- ★ Part ii was on examining the determinants of trends in international trade of which the facility percentage was 35%. The question is to examine the trends in international trade based on the absolute and comparative advantage. However the candidates seem not having the required skill to understand these trends, which is clearly demonstrated by the failure rate of 65%.
- ★ Part iii examined the global and regional approaches to eliminate the barriers in international trade and to state the differences among the two approaches. The facility percentage for this question is 17%. This depicts that 83% of the candidates does not have the knowledge on the above subject area. Thus the teaching-learning system should be organized to describe, differentiate and also increase the knowledge on global and regional approaches in eliminating the barriers to international trade.
- ★ Part iv was aimed to examine pros and cons of the flexible foreign exchange rate system. The facility percentage of this question was 29% which is not satisfactory. Majority of the candidates did not have the required understanding and the knowledge in this area. Thus the teaching system should be organized to increase the student understanding on pros and cons of the flexible foreign exchange rate system.
- ★ Part v examines the current trends in exports and imports of Sri Lanka and analyzes the reasons for the current trade deficit in Sri Lanka. The facilitation for this part was 13% and 87% of the students recorded a difficulty in answering the question as a result of poor knowledge in the current trends in exports and imports in Sri Lanka. Hence the knowledge in expanding trade deficit in Sri Lanka and the causes for it should be explained to the students.

Question 9

9. (i) Critically examine the difference between economic growth and development. (05 marks)
- (ii) Outline the main factors which determine the level of productivity in a country. (05 marks)
- (iii) "Although Sri Lanka's human development achievement at national level is impressive, there are disparities in human development across provinces and sectors." Explain. (05 marks)
- (iv) Identify the salient features of demographic transition in Sri Lanka. What are their economic implications? (05 marks)

Expected answer and the marking scheme

09. (i) - Economic growth is the sustained increase in the productive capacity (potential output) of the economy.
- Economic growth is a narrower concept than development. It is an increase in a country's real level of national output which can be caused by an increase in the quality of resources, increase in the quantity of resources & improvements in technology. Economic Growth can be measured by an increase in a country's GDP.

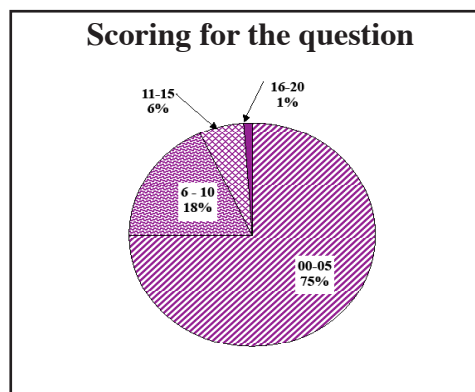
- Development is a normative concept. It means an increase in living standards, improvement in self-esteem needs and freedom from oppression as well as a greater choice. A better quality of life calls for higher incomes; but it involves much more.
 - True development is shown by evidence of improvements along many dimensions, not only a few. Measuring it adequately requires multiple indicators, which need not be combined in a single index.
 - Economic Growth does not take into account the depletion of natural resources which might lead to pollution, congestion and disease. Development however is concerned with sustainability which means meeting the needs of the present without compromising future needs.
 - Economic growth is necessary but not a sufficient condition for development.
(02 marks each for any three reasons and total marks; 05)
- (ii) - Determinants of productivity :
- Labour quality : Education, vocational training experience
 - Technology
 - Innovations : Research and development
 - Capital investment
 - Financial market development
 - Natural resources
 - Infrastructure
 - Regulations
 - Attitudes
- (iii) - Sri Lanka has the highest level of human development among the eighth SAARC countries. The 2013 Human Development Report shows that with an HDI of 0.715 in 2012, Sri Lanka ranked 92 out of 187 countries. Sri Lanka has already achieved the MDG on poverty, well before the 2015 deadline. Based on the national poverty lines, the incidence has declined from 26.1% in 1990/91 to 8.9% in 2009/10.
- Despite these national level achievements, there are significant disparities across provinces, districts and sectors. Regional differences in poverty is still prevalent in some districts, especially those affected by conflict or with large estate population despite the overall national decline. In the Batticaloa district, poverty in Ampara district rose from 10.9% in 2006/07 to 11.8% in 2009/10.
 - As usual the western province is contributing around 44% to GDP but contrary to the Northern Province is contributing only 4% and the Uva province's contribution to GDP is also very low at 5% followed by North Central.
 - There are significant differences in infrastructure facilities. In the estate sector 23% of the household do not have access to electricity and 40% of the households do not get safe drinking water.
 - The disparity in access to Upper secondary education was greater on estates, where only 54% of children were enrolled, compared to 86% and 81% for urban and rural sectors respectively.
(02 marks each for any explanation and maximum marks : 05)
- (iv) - It is a transition from undesirable state of slow growth of population where mortality and fertility rates are high to a desirable state of slow population growth with low fertility and mortality levels.
- The age structure of population has changed from a pyramid shape to a cylindrical shape indicating an increase in old age population as compared to the child population.

- The population in the age group of 60 and above is 11% at present and expected to increase 16% in 2020 and 29% in 2050.
- There is a decreasing trend for the population in the age group 25-54 which comprises a major portion of the labour force.
- Give their higher life expectancy, female will live longer than males to advanced ages. This is clearly evident where one looks at the sex ratio at advanced ages. It suggests that there will be more widowed women in the old ages.

(01 mark each for any two characteristics and total marks : 02)

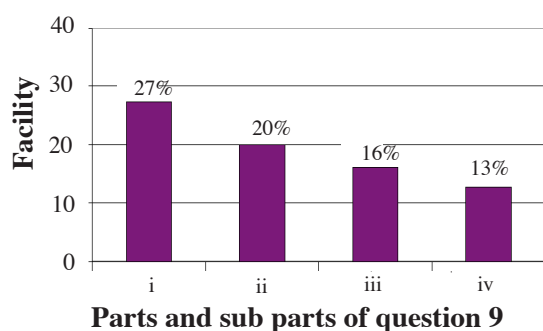
- There are important economic implications of demographic transition : The burden of the retirement benefits on the employers would be very heavy. The increase in the recurrent expenditure of the government would be major threat to the allocation of funds for public investment. This could have an adverse effect on economic growth of the country.
- Government will have to bear a heavy cost to maintain the old age population (health service etc.)
- Domestic savings could be affected adversely as the old age population will try to maintain their consumption flow using their past savings.
- The increase in dependency ratio would impose an extra burden on the incomes of working population. This will also contribute to reduce the level of savings in the economy.
- The decline in fertility rate could cause a reduction in labour force. This can adversely affect the labour force.
- Physical infrastructure in education will not be required as the number of children below 15 years of age will decrease. These resources can be diverted to improve the quality of education.

Overall observations and conclusions regarding the answers to Question 9 :



44% of the candidates have answered this question. (refer the graph no 1.3.2) 20 marks is allocated for this question out of which 75%, 18%, 6% and 1% has earned marks between the range of 0-5, -10, 11-15 and 16-20 respectively.

Facility of parts and sub parts of the question



This question consists of 4 subparts of which part (i) is recorded the easiest question. Its facility percentage is 27%. The question recording the lowest facility percentage is part (iv) which records a facilitation of 13%. Considering all the questions, this question is one of the questions having lowest facilitation.

- ★ The facility percentage of part i is 27% through which the ability of critical analysis on the difference between the concepts of economic growth and development was tested through this question. The fact of 73% difficulty rate being recorded for this part demonstrates that the students lack the knowledge on the above subject area. Thus the student skill on critically analyzing the differences and inter-relationships in economic growth, economic development and development should be enhanced.
- ★ Part ii examines the determinants of a country's productivity level. The success rate at this question is 20% where the majority of the candidates have failed to give the correct answer due to the inability of explaining the determinants of productivity level using various new approaches. Thus students' skill on explaining the determinants of productivity levels using current information should be developed.
- ★ Part iii test the knowledge on national, provincial and sectorial analysis and comparison of the current performance of the Sri Lankan human development goals. The facility percentage is 16% which demonstrate that the candidates lack the knowledge on data and statistics on the above subject area. Thus the teaching-learning system should be organized to develop the skill required for the above analysis.
- ★ Part iv is on describing the significant characteristics of demographic transition in Sri Lanka for which the facility percentage is 13%. The majority of the candidates have failed in this question due to not being updated on the social changes of Sri Lanka. Therefore, teaching-learning system should be organized to provide the understanding about the current status of the social change in Sri Lanka.

Question 10

10. (i) Examine the recent trends in Sri Lanka's saving-investment gap. (04 marks)
- (ii) What are the implications of negative saving-investment gap for the economy of Sri Lanka which is expected to reach a level of per capita income of over US \$ 4 000 before 2016? (06 marks)
- (iii) What are the challenges facing the tourism sector in Sri Lanka to develop country as a major tourist destination in Asia? (05 marks)
- (iv) To what extent do you think having good governance is a key to poor countries achieving stable and long term economic growth? (05 marks)

Expected answer and the marking scheme

10. (i) Trends in savings-investment gap :

Savings - investment Gap Percentage of (GDP)				
Year	Savings		Investment	Domestic Savings investment gap
	Domestic	National		
2010	19.3	25.4	27.6	-8.3
2011	15.4	22.0	30.0	-14.6
2014	17.0	24.0	30.6	-13.7

- 10 (ii) - To attain higher economic growth, Sri Lanka needs to enhance the level of national savings and investment over the medium to long term. With the economy expected to reach a level of over US \$ 4,000 per capita before 2016, gross investment needs to rise to above 33% of GDP, from the current level of around 30% of GDP. (02 marks)
- At present the savings-investment gap in Sri Lanka is negative and remains around 7-8% of GDP. (In year 2012, national savings were 24% of GDP and investment was 30.6%). (01 mark)
 - The negative saving-investment gap is reflected on the balance of payments of the country as a deficit in the current account. The financing of the current account deficit would result increase in external debt and/or decrease in external assets.
 - Large inflows of external financing could partly bridge the savings investment gap, although, such inflows may lead to an appreciation of the domestic currency, eroding external competitiveness, thereby.
 - Increase in external debt service payments could be an additional burden on the government budget and marks it difficult to achieve fiscal target of 5% budget deficit.
 - Given the resource constraints facing the public sector, further increase in the level of investment from the current level of 30% of GDP to 33% of GDP may not be possible from the government. The local and foreign private investment need to be encourage by providing a conducive investment climate in the country.
- (02 marks each and total marks : 06)
- (iii) - Tourism sector in Sri Lanka is expected to play a very important role in the country's economy in the coming years. Sri Lanka expects 2.5 million tourist arrivals in 2016. There are number of challenges Sri Lanka may encounter in developing this sector.
- We have to create an environment in the country that is conducive for tourism. Sri Lanka needs to develop its image in the major western markets. The global perception matters a lot for a country when it is expected to become a major tourism destination.

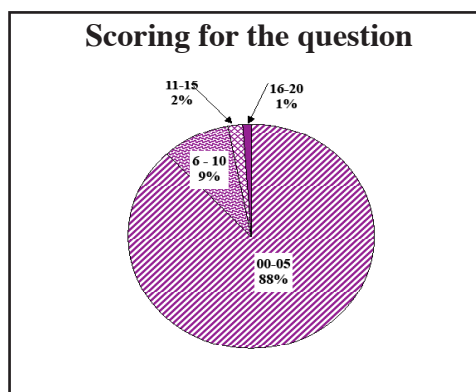
- There is an urgent need for a clear, market driven tourism strategy that directs the future marketing and development of key tourism attractions towards greater diversification and market expansion. The existing approach is primarily supply driven and does not give due recognition to demand trends.
 - The room capacity available at present is inadequate to meet the future needs. According to statistics available, if we consider the average stay of a tourist as six nights then there will be a requirement of 40,000 rooms to cater to the demands of two and a half million tourists. With a combined total of 22,000 rooms already across the formal and informal sectors, the country requires an additional 18,000 rooms.
 - To build 18,000 rooms you need at least US\$ 1.5 billion and need to attract new investors.
 - A substantial government investment would be required to make tourism areas and attractions more accessible and appealing to a wider range of potential tourist segments, i.e. road and railway development and upgrading, airstrip improvements etc.
 - There is an urgent need to have trained and skilled manpower with high quality and good customer-care attitudes within a short time period. (05 marks)
- (iv) - Recently the terms “governance” and “good governance” are being increasingly used in development literature. Bad governance is being increasingly regarded as one of the root causes of all evil within our societies. Major donors and international financial institutions are increasingly basing their aid and loans on the condition that reforms that ensure “good governance” are undertaken.
- Governance means : the process of decision-making and the process by which decisions are implemented (or not implemented). Governance can be used in several contexts such as corporate governance, international governance, national governance and local governance.
 - Good governance has 8 major characteristics. It is participatory, consensus oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive and follows the rule of law. It assures that corruption is minimized, the views of minorities are taken into account and that the voices of the most vulnerable in society are heard in decision-making. It is also responsive to the present and future needs of society.
 - Good governance is a precondition for economic development. The quality of governance plays a vital role in the economic development of countries. The management of public finance is one clear area where governance is of paramount importance. Fiscal consolidation or bringing down budget deficit to reasonable level is vital for a poor country to avoid inflation, find resources for development needs and social welfare expenditure on priority basis.
 - Apart from the public finances, there are other important areas of economics activity that

is affected by poor governance. Foreign investment is one of them, Foreign investors are often discouraged by official who demand bribes to permit foreign investment in various vital sectors where foreign investment is needed.

- The enforcement of the rule of law and protection of property rights and fundamental rights of citizens have an important bearing on economic development.

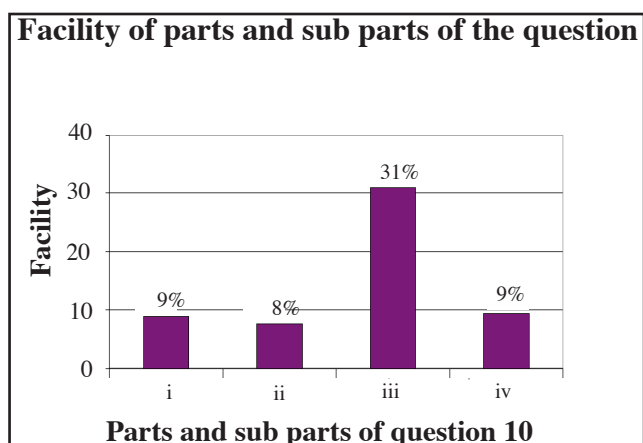
(02 marks for any reason and total marks : 05)

Overall observations and conclusions regarding the answers to Question 10 :



The question no 10 is the one which only a minority of the candidates have chosen to answer. (refer graph no 1.2.3) which is 16%. 20 marks is allocated for this question out of which selected intervals:

00 - 05	—	88%
06 - 10	—	9%
11 - 15	—	2%
16 - 20	—	1%

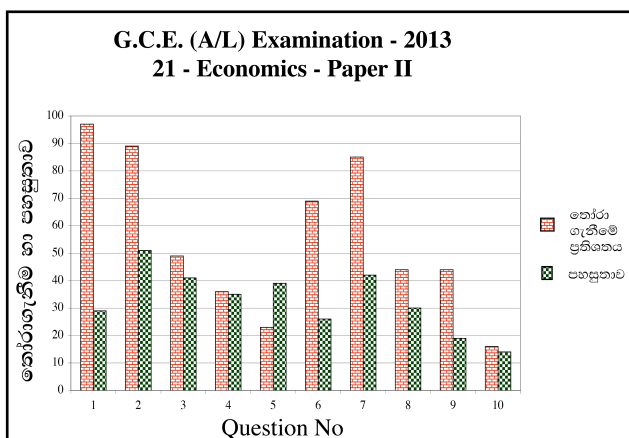


The question consists of 4 subparts of which part (ii) has been recorded as the most difficult part. The facility percentage of this part is 08%. The subpart with the highest facility percentage is part (iii) which records a facilitation of 31%. Part (i) and (iv) is among the parts with lower facilitation which is 09%. This question records a lower facilitation in considering the overall situation.

- ★ The facility percentage for part i is 9% which is lower. One reason for this could be due to not knowing economic situation for past years. It is also noted that the candidates prefer not choosing questions requiring data and statistics.
- ★ Part ii of the question records the lowest facilitation which is 08%. The question aims to test the analytical skill using the current savings-investment gap but the candidates seem to fail in answering the question. The teaching-learning system should be organized to enable the students to engage in analytical mind set.
- ★ Part iii is the subpart which records the highest facilitation which is of 31%. It is noted that the candidates are having a good understanding on the tourism industry which may be due to the high government attention on tourism industry. The success rate for such questions can be increased by motivating the students to engage un information searching.
- ★ The facilitation for part iv is 9% which could have been due to the fact that concepts such as good-governance / governing being new to the candidates. The success rates could be increased by organizing the teaching-learning system to motivate the candidates to engage in extra-reading.

2.2.3 Total observations, conclusions and suggestions with regard to answering paper II

Following table and the graph indicate the selection percentage and the facilitation which were calculated organizing the data used for each question in paper II.



Question No	1	2	3	4	5	6	7	8	9	10
Selection percentage	97	89	49	36	23	69	85	44	44	16
Facilitation (as a percentage)	29	51	41	35	39	26	42	30	19	14

The question paper consists of ii parts namely a and b. Part a consist of question 1 to 05 whereas the part ii consist of question no 06- 10. The candidates should answer at least two questions from part a and two questions from part b totaling to maximum 05 questions.

Out of the question in part a) question no 01 and 02 records the highest selection rates whereas question no 06 and 07 is recorded as the most selected questions in part b where the selection percentages are 97%, 89%, 69% and 85% respectively. The next in order of the selection percentage is for question no 03 where it is being selected out of 06 optional questions where 50% of the candidates have chosen this question. The subject areas of these questions are seemed to be the most highlighted by the teaching-learning system and post popular subject areas from the syllabus. Thus the facilitation of these questions should be higher. The questions no 1, 2, 6, and 3 are located at the beginning of the questions taken from descending order according to the selection percentage. But by considering the facility percentage of these questions and question no 2,7,3,5 and 4 is located at the beginning. Although question no 1 and 6 records a higher selection rate, the success rate in answering the question is recorded at a very low level. Thus the teaching-learning system should be organized to direct the students to earn more marks in such questions as they are popular subject areas in the syllabus.

Question no 02 records the highest facility percentage which was 51%. The fact that this is limited to 51% should bring in to attention of economists who are interested about future progress in this subject. Students should be guided to answer in a self-motivated way and a manner in which they could earn the higher percentage of marks allocated for the question.

The lowest selection rate is recorded for question no 10 and the facilitation is also a lower percentage as 14%. This is based on the low-attention given at the teaching-learning system on the subject area.

The relevant authorities should be brought into attention of the fact that the easiest question in paper II has recorded a facility percentage of 51% and the facility percentage of the rest of the questions other than question no 2,3 and 7 is recorded to be lower than 40%. Also the overall facilitation of paper II is only 33%. This concludes that the teaching-learning system should be directed to enhance the students' skill with remedial programmes.

III Parts

3.0 Important notes and suggestions on answering :

3.1. Important notes on answering

Common Instructions

- ★ General instructions should be read and well understood. That is in the selection of questions, the number of questions to be answered from each part, compulsory questions, and the time allocation under each section should be taken into careful consideration and questions should be selected after having well-read and clearly understood.
- ★ Only one choice should be selected in answering the 1st paper and a clear cross (X) should be marked on the answer sheet.
- ★ In answering the questions in paper 2 every question should begin in a new page.
- ★ Should write clear and legible answers.
- ★ Index number of the candidate should be written in each relevant place in each page.
- ★ Question numbers and numbers of sub parts should be written correctly.
- ★ Lengthy descriptions should not be included when specific short answers are expected and vice versa.
- ★ Facts should be analytically and logically presented depending on the nature of the question provided.
- ★ Red and green coloured pens should not be used when answering.
- ★ Time should be managed according to the time available and the amount of marks offered for each question.