01. Select from (1), (2), (3) and (4) the most correct answer to each of the following questions. Write the number of the selected answer in your answer booklet with the English letter assigned to the question.

(A) Select from the following, the sentence which describes "Merit Goods":

(1) The goods for which the demand fall with the rise in household income.
(2) The goods for which the demand increase with the rise in household income.
(3) The goods that the government influences and encourages to be consumed.
(4) The goods that give negative externalities to the society when consumed.

(B) The diagram below shows production possibility curves before and after a technical discovery affecting the production of good $x$:

Select from the following the distance that represents the increase in production of good $y$ due to the above technical discovery:

(1) KL  (2) KN  (3) LN  (4) MZ
(C) (a) Private ownership of property.
   (b) There is an inequality of income.
   (c) Operation of the price mechanism.
   (d) Production and distribution are performed by the government.

Out of the above characteristics, the correct main characteristics of market economy are shown in which of the following?

(1) (a), (b) and (d) only.  
(2) (a), (b) and (c) only.  
(3) (a) and (d) only.  
(4) (a), (c) and (d) only.

(D) In responding to a fall in price of a commodity, consumer buys more of that commodity. The result of this is:

(1) Shift the consumer’s demand curve to left.  
(2) Movement downwards along the consumer’s demand curve.  
(3) Shift the production possibility curve to right.  
(4) Rise in the price of substitute goods.

(E) You are given the following demand and supply equations for a commodity.

\[ Q_d = 80 - 10p \]
\[ Q_s = -40 + 20p \]

The equilibrium price of the commodity is:

(1) Rs.5/-  
(2) Rs.15/-  
(3) Rs.4/-  
(4) Rs.20/-

(F) One of the reasons for shifting the supply curve to the right is:

(1) Fixing a maximum price.  
(2) Granting a subsidy to producers.  
(3) Fixing a minimum price.  
(4) Granting a subsidy to consumers.

(G) (a) An indifference curve slopes downwards from left to right.
   (b) Indifference curve is convex to the origin.
   (c) An indifference curve describes a relationship between total cost and marginal cost of a firm.
   (d) Two indifference curves do not intersect each other.

Out of the above characteristics, the correct characteristics of indifference curves are shown in which of the following?

(1) (a) and (c) only.  
(2) (a), (b) and (c) only.  
(3) (a), (b) and (d) only.  
(4) (a), (c) and (d) only.
(H) The cross elasticity of demand of good $x$ with respect to good $y$ is described as:

1. \[ \frac{\text{Percentage change in quantity demanded of good } x}{\text{Percentage change in price of good } y} \]
2. \[ \frac{\text{Percentage change in quantity demanded of good } y}{\text{Percentage change in price of good } x} \]
3. \[ \frac{\text{Percentage change in quantity demanded of good } x \text{ and } y \text{ combined}}{\text{Percentage change in their joint prices}} \]
4. \[ \frac{\text{Percentage change in quantity demanded of good } x}{\text{Percentage change in quantity demanded of good } y} \]

(I) The following diagram shows demand and supply curves of a market for good $Z$.

![Diagram of demand and supply curves with consumer surplus]

The consumer surplus is shown by the area of:

1. OPAQ  
2. PAP1  
3. P2PA  
4. P2P1A

(J) Which one of the following is not a capital expenditure of the government?

1. Acquisition of real assets such as buildings and machinery.
2. Salaries and wages of government employees.
3. The funds provided to government corporations and statutory boards for investments.

(K) The household income of a country can be estimated by calculating which of the following?

1. Total of all factor income.  
2. Profits of business enterprises.  
3. Sum of all savings.  
4. Property income from abroad.

(L) According to the Annual Report of the Central Bank of Sri Lanka for the year 2011, the rate of unemployment of Sri Lanka in 2011 was:

1. 6.0%.  
2. 5.4%.  
3. 5.8%.  
4. 4.2%.
(M) When the rate of interest is increased, which one of the following is likely to happen to the share market prices?

(1) Increase.
(2) Decrease.
(3) Remain unchanged.
(4) Increase in prices of new shares only.

(N) Select from the following the example for money substitute:

(1) Treasury bills. (2) Fixed deposits.
(3) Credit Cards. (4) Share Certificates.

(O) Which one of the following is not a function of money?

(1) Act as an unit of account. (2) Act as a means of deferred payments.
(3) Act as a store of value. (4) None of the above functions.

(P) The table below shows the composition of the money of a country for a year.

<table>
<thead>
<tr>
<th></th>
<th>Rs. (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Currency held by the public</td>
<td>10,400</td>
</tr>
<tr>
<td>Demand deposits held by the public in commercial banks</td>
<td>20,800</td>
</tr>
<tr>
<td>Increase in bank lending to the private sector</td>
<td>12,000</td>
</tr>
<tr>
<td>Savings and time deposits held by the public in commercial banks</td>
<td>38,400</td>
</tr>
</tbody>
</table>

Broad Money Supply (M₂) of the country is:

(1) Rs. 69,600/- million. (2) Rs. 81,000/- million.
(3) Rs. 71,200/- million. (4) Rs. 43,200/- million.

(Q) Select from the following the correct statement in relation to the term “devaluation of local currency”:

(1) A reduction in the external value of the domestic currency in terms of other foreign currencies by the intervention of the monetary authority.
(2) Adjustment of the exchange rate to equate external payments and receipts from imports and exports.
(3) Decline in the exchange rate in accordance with the demand and supply of the currency.
(4) Maintenance of the external value of the domestic currency at a level higher than what it should be.
Select from the following an example for Negative Externalities:

1. Technical training.
2. A private motorist provides transport facility to others.
3. Benefits of personal health habits to others.

What is meant by public debt?

1. The total loans and advances obtained by general public from banking sources.
2. The total loans obtained by the public enterprises to finance their deficits in expenditure.
3. The total loans obtained by the government from domestic and foreign sources to finance the budget deficit.
4. The total loans obtained by the government from international agencies to finance development projects.

According to the Annual Report of the Central Bank of Sri Lanka for the year 2011, the economic growth of Sri Lanka in 2011 was:

1. 9.1%.
2. 8.3%.
3. 6.4%.
4. 7.8%.

(SECTION - B)

Answer any four (04) questions only from this Section
60 marks

02. (a) (i) List the main production resources. (02 marks)
     (ii) Explain briefly the main production resources. (04 marks)

     (b) Explain main functions of price in a market economy. (05 marks)

     (c) List four (04) factors which determine the price elasticity of demand. (04 marks)

     (Total 15 marks)

03. (a) (i) What is meant by the “Returns to Scale”? (02 marks)
     (ii) With the help of a graph, explain briefly the stages of returns to scale. (04 marks)

     (b) List four (04) conditions for market equilibrium. (04 marks)

     (c) (i) What is meant by “Price Discrimination”? (02 marks)
            (ii) List three (03) methods of price discrimination. (03 marks)

     (Total 15 marks)
04. (a) With the help of a graph, explain the consumer equilibrium. (06 marks)

(b) (i) Describe the concept of income elasticity of demand. (02 marks)
(ii) As a result of an increase in monthly income from Rs.2,000/- to Rs.2,400/-, a person’s expenditure on housing goes up by 20%. What is the income elasticity of demand for housing? (02 marks)

(c) What are the consequences if the government imposed a maximum selling price below the equilibrium price? (05 marks)

(Total 15 marks)

05. (a) List five(05) advantages of national income accounts. (05 marks)

(b) You are provided the following data pertaining to economy $x$ in relation to National Income:

<table>
<thead>
<tr>
<th></th>
<th>Rs. (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exports</td>
<td>8</td>
</tr>
<tr>
<td>Government current expenditure</td>
<td>7</td>
</tr>
<tr>
<td>Imports</td>
<td>9</td>
</tr>
<tr>
<td>Gross domestic capital formation</td>
<td>8</td>
</tr>
<tr>
<td>Private consumption</td>
<td>27</td>
</tr>
<tr>
<td>Net factor income from abroad</td>
<td>1</td>
</tr>
<tr>
<td>Taxes on expenditure</td>
<td>4</td>
</tr>
<tr>
<td>Subsidies</td>
<td>1</td>
</tr>
</tbody>
</table>

(i) Calculate the Gross Domestic Product (GDP) at factor cost prices. (06 marks)

(ii) Calculate the Gross National Product (GNP) at factor cost prices. (04 marks)

(Total 15 marks)

06. (a) List five(05) characteristics of good money. (05 marks)

(b) State five(05) effects of a rise in the general price level of a country. (05 marks)

(c) Explain what is meant by “Cost Push Inflation”. (05 marks)

(Total 15 marks)

07. (a) State five(05) principles of taxation. (05 marks)

(b) (i) Define Direct Tax with an example. (03 marks)
(ii) List two(02) advantages of Direct Tax. (02 marks)
(c) State five(05) consequences to a country like Sri Lanka with the rise in crude oil prices in the international market. (05 marks)

(Total 15 marks)