**Association of Accounting Technicians of Sri Lanka**

# Level I Examination – July 2026

# Question Paper and Suggested Answers

# (1603) ECONOMICS (ECN)

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THE ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

# Level I Examination – July 2026

# (1603) ECONOMICS

# SUGGESTED ANSWERS

(Total 40 Marks) **SECTION - A**

## *Suggested Answers to Question One:*

**1.1** (2)

**1.2** (4)

**1.3** (1)

**1.4** (2)

**1.5** (2)

**1.6** (3)

**1.7** (1)

**1.8** (2)

**1.9** (4)

**1.10** (2)

**1.11** Normal (zero)

**1.12** Increasing

**1.13** False

**1.14** True

**1.15** Opportunity Cost

**The opportunity cost** of a choice is the value of the next best alternative foregone when a decision is made. Here it is important to note that the opportunity cost is not the cost of all the alternatives given up when choosing one option, but the cost of only the next best alternative.

**1.16** Substitution Effect

When all other factors remain constant, including the prices of related goods, substitution effect of a price change is the response of consumers to the relative price change as a result when the price of a good changes.

**1.17** Two Determinants of Economic Growth (7.11)

- Factor Endowment
- Productivity
- Economic Stability
- Political Stability
- Good Governance
- Incentives

**Alternative Answer:**

- Physical capital.
- Human capital.
- Natural capital.
- Social capital.
- Technology.
- Innovation.
- Investments on R & D

**1.18** Two Differences Between Needs and Wants(1.1.5)

| Needs | Wants |
|---|---|
| Needs are common to all, | Wants differ from person to person. |
| Needs are Limited | Wants are Unlimited |
| Needs are Primary | Wants are Secondary |
| It is a must that these are fulfilled | Not a must to fulfil them. |
| Needs Cannot be influenced through advertizing | Wants Can be influenced through advertising |

**1.19** Factors that shift the demand curve to the left.(2.2.3.2)

- Decrease in the price of substitution goods.
- Increase in the price of complementary goods.
- Decrease in the consumer income.
- Decrease in the consumer taste and preference.
- Expectation that the price of the good will decrease in the future.
- Decrease in the number of consumers (Buyers).

**1.20** Economic Development (7.2)

Economic Development means the quantitative and qualitative improvement of all spears of human life, more importantly economic, political, social and cultural spears and the development is a multidimensional process.

**Or**

Economic Development is an evolutionary process of economic growth. What this implies is the economic development reflects the changes of the economic structure that occurs along economic growth.

***(02 marks each, Total 40 marks)***

**Total 40 Marks** **SECTION - B**

## *Suggested Answers to Question Two:*

**(a)** Characteristics of Economic Goods (Section1.3.3.3)

- Existence of limitation/scarcity in supply.
- Existence of cost of resources.
- Existence of opportunity cost.
- Most of the economic goods are having a price.
- Economic goods are an outcome of a production process.
- Existence of a clear ownership

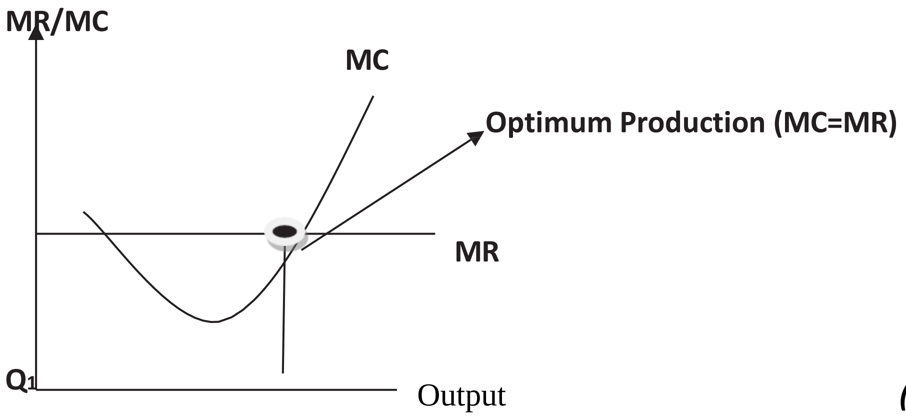
***(03 marks)***

**(b)** Three basic economic problems: *(3 marks)*

1. What to produce and in what quantities?
2. How to produce?
3. For whom to produce?

***(03 marks)***

**(c)** Profit maximization of a perfectly competitive firm in the short run:
A perfectly competitive firm maximizes profits in the short run by producing the quantity where MC = MR, selling that quantity at the market price, and earning economic profits if price exceeds the minimum point on the ATC curve. The firm will shut down if price falls below AVC in the short run. Below illustrated is how to determine the profit-maximizing Quantity and price using a graph.




***(04 marks)***

***(Total 10 marks)***

## *Suggested Answers to Question Three:*

**(a)** Law of Supply:

The principal that explains the positive relationship between the price of a good and the quantity supplied of that good over a given period of time, when all the factors that determine the supply, except the price of the own good, remain constant is referred to as the law of supply.

***(03 marks)***

**(b)**

Given:

Qd = 180 - 3P

Qs = 20 + 2P

At equilibrium: Qd = Qs

180 - 3P = 20 + 2P

180 - 20 = 2P + 3P

160 = 5P

32 = P

Substitute P = 32 into Qd or Qs

180 – 3p = Q

180 – 3 × 32 = Q

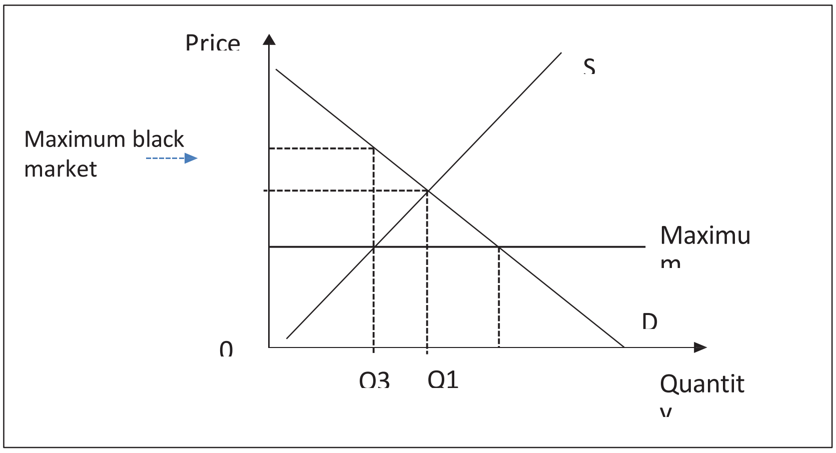
180 – 96 = Q

**84 = Q**

***(03 marks)***

**(c) Consequences of imposing a maximum price (Price Ceiling) (2.10.3.1)**

Maximum legal price is imposed by the government with the intention of bringing down the price of a good that prevails in a market. Mostly a maximum legal price is imposed on essential consumer items like bread, flour and gas and the maximum legal price becomes an effective price only when the legally determined price is lower than the market equilibrium price. The impact of the imposition of maximum legal price can be graphically explained as follows.




However suppose the maximum legal price imposed by the government is $P_2$, and as shown, at this price the quantity consumers are willing to purchase is $Q_2$. Yet the quantity that the suppliers are willing to supply at price $P_2$ is $Q_3$ and this creates an excess demand (shortage) that is equivalent to $Q_2 – Q_3$. Generally when a shortage of a good exists, a tendency prevails in a market to shift towards the equilibrium position. However when a maximum legal price prevails, it is illegal to sell at a price higher than the legally determined price, therefore market forces cannot push the price of the given good upwards in order to clear the shortage that exists. Selling the good at a price higher than the legally determined price is considered as selling at a black market price.

***(04 marks)***
***(Total 10 Marks)***

## *Suggested Answers to Question Four:*

**(a) Three functions of the Central Bank of Sri Lanka(5.4.2)**

1. Determine and implement monetary policy;
2. Determine and implement the exchange rate policy;
3. Hold and ensure the prudent and effective management of the official international reserves of Sri Lanka;
4. Issue and manage the currency of Sri Lanka;
5. Administer, supervise and regulate payment systems and ensure the safety, effectiveness, and efficiency of such payment systems;
6. Register, license, regulate and supervise financial institutions;
7. Resolve financial institutions regulated and supervised by the Central Bank;
8. Adopt and implement macro prudential policy measures;
9. Collect and produce statistics;
10. Act as financial advisor and banker to the Government;
11. Act as fiscal agent of the Government to the extent provided for by or under any written law;
12. Inform Parliament, Government, and the public about its policies and operations
13. Cooperate with and participate in international organizations, including public international financial institutions, and cooperate with domestic and foreign public institutions, concerning matters related to its objects;
14. Promote financial inclusion in Sri Lanka;
15. Establish deposit insurance and liquidity support schemes as means of securing the financial system stability;
16. Hold, sell and dispose of property, both movable and immovable, and enter into contracts;
17. Acquire and hold such assets and incur such liabilities as it may deem necessary; and generally, do all such acts and things as are necessary for, or incidental or conducive to the

***(04 marks)***

**(b)**

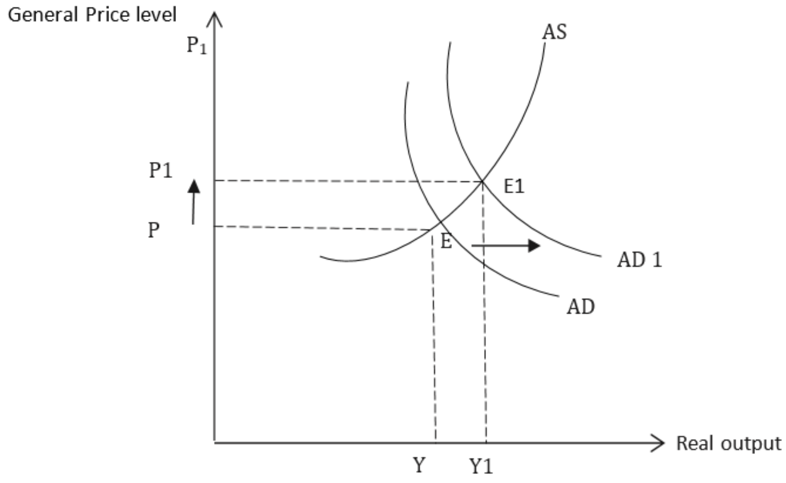
- Transaction Motive
- Precautionary Motive
- Speculative Motive

***(03 marks)***

**(c) Two causes of inflation:**

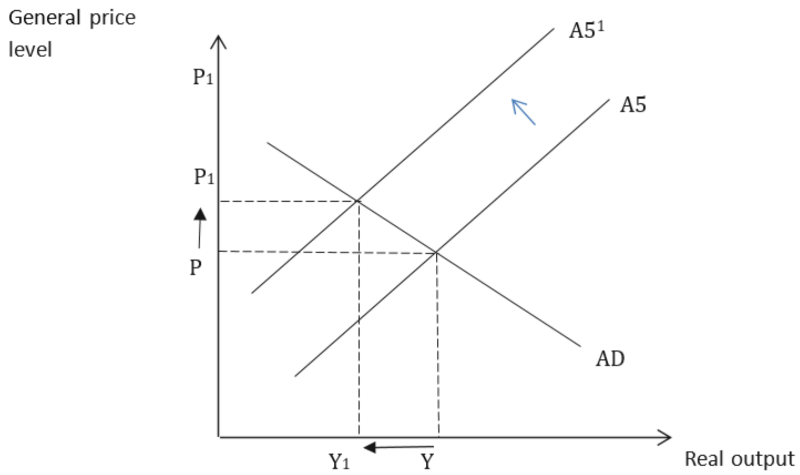
Demand Pull Inflation (Section 5.10.2)

Demand Pull Inflation is the type of inflation that results when an economy's aggregate **demand exceeds its aggregate supply**. To put this in simple terms, when production cannot keep up with the aggregate demand, higher prices quickly follow.




This graph shows demand-pull inflation**.** Aggregate demand shifts right from AD to AD1, causing the economy to move from equilibrium E to E1, increasing both price level (P to P1) and real output (Y to Y1).

**Cost-Push Inflation:** Occurs when production costs rise (e.g., higher wages, higher raw material prices, fuel prices), shifting aggregate supply to the left and driving up price levels




***(04 marks)***

***(Total 10 marks)***

## *Suggested Answers to Question Five:*

**(a) Advantages of International Trade (6.1.1)**

- Acceleration of economic growth.
- Growth in international economic cooperation.
- Ability to obtain foreign technology from developed countries / Transfer of technology and knowledge
- Ability to find a market to sell the surplus production.
- Use the resources efficiently and effectively towards the production.
- Ability to buy the goods which cannot be produced domestically.
- Ability to consume high quality products at a lower price.
- Inflow of foreign loans, foreign grants and foreign investments to the country.
- Greater variety of goods available for consumption.
- Efficient allocation and better utilization of resources since countries tend to produce goods in which they have comparative advantage.
- Promotes efficiency in production as countries will try to adopt better method of production to keep cost down in order remain competitive.
- More employment could be generated in the areas of transportation, banking, insurance etc, as the market for the countries' goods widen through trade.
- Non economic advantages in relation to areas like political, social and cultural to be gained by fostering trade in international organizations.

***(03 marks)***

**(b)** Types or transactions recorded in Balance of Payment (6.4.1)

- Balance of trade in goods
- Balance of trade in services
- Net primary income
- Net secondary income
- Sale /transfer of patents, copyrights, franchises, leases and other transferable contracts and goodwill
- Transfer of ownership of assets.
- Foreign direct investments
- Portfolio flows
- Balance of banking flow ***(03 marks)***

**(c) Two impacts of Middle East conflict on the Sri Lankan economy:**

**Increased Import Expenditure / Energy Inflation:** Conflict in the Middle East disrupts global oil supplies, raising international crude oil prices. This increases Sri Lanka's import bill, driving up domestic fuel, transport, and electricity costs.

**Disruption to Remittances & Tourism:** Unrest reduces foreign employment stability for Sri Lankans in the region, threatening worker remittance inflows, which are a major foreign exchange source for Sri Lanka.

**Depreciation of Exchange rate :** In addition, the higher import bill increases the demand for foreign currency, especially US dollars, while foreign exchange inflows such as remittances and trade earnings may become uncertain. This creates pressure on the exchange rate, leading to a depreciation of the Sri Lankan Rupee.

**Eroding BPO position :** Furthermore, increased import costs and reduced economic stability can worsen the Balance of Payments position and slow down overall economic growth in Sri Lanka.

**Lack of Investment confidence :** Moreover, rising production costs and economic uncertainty can reduce business confidence and private investment. This may slow down production and overall economic growth in Sri Lanka.

**Increased cost of living and decline in living standards:** Households experience a higher cost of living due to increased prices of fuel, transport, and essential goods, reducing real income and living standards.

***(04 marks)***

***(Total 10 marks)***

***End of Section B***

## *Suggested Answers to Question Six:*

**(A)**

**(a) Gross Domestic Expenditure (GDE) at market price:**

| Item | Rs. million |
|---|---|
| Private consumption expenditure | 52,000 |
| Government consumption expenditure | 12,500 |
| Gross domestic fixed capital formation | 11,000 |
| Changes in stock and Changes in value | 7,500 |
| **Gross Domestic Expenditure (GDE) at market price** | **83,000** |

***(05 marks)***

**(b)**

| Item | Rs. million |
|---|---|
| Gross Domestic Expenditure (GDE) | 83,000 |
| Add: Exports of goods and services | 4,400 |
| Less: Imports of goods and services | (3800) |
| **Gross Domestic Product (GDP) at market price** | **83,600** |

***(03marks)***

**(c)**

| Item | Rs. million |
|---|---|
| Gross Domestic Product (GDP) at market price | 83,600 |
| Add: Foreign net primary income | 6,425 |
| **Gross National Income (GNI) at market price** | **90,025** |

***(02 marks)***

**(B)**

Phases in the business cycle (4.2)

- Peak
- Declining stage / Depression
- Trough
- Expanding Stage/ Expansion

***(02 marks)***

**(C)** Limitations on national income accounts (4.4.7)

- Non-inclusion of productive activities taking place in informal economy
- Non-inclusion of dependent economic activities in national production
- Non-inclusion of services provided by housewives in national production
- Non-inclusion of interest paid on public debts in national production calculations
- Non consideration of damage to environment due to production activities
- Non consideration of changes of productivity in public services
- Inclusion of expenditure on defense and wars under productive activities
- Non-inclusion of some consumer goods with long lifespan in national production by categorizing them as investments.

***(03 marks)***

**(D)** The impact of fiscal policy on business activities (4.9)

- Business will see more investment opportunities related to government spending. This commonly occurs during the expansionary fiscal policy when more money is following in to the economy from the government and from other sources. Since taxation is also low. When balance between price and demand is met then companies can expect to thrive and grow.
- On the other hand, contactionary fiscal policy calls for higher taxes and reducing spending. This has a direct impact on a business's bottom line.
- The government will have to resort to borrowing when its revenue is not sufficient to cover its expenditure and this could have upward pressure on the interest rate of the economy. Higher rate of interest discourages investments and what this implies is that higher government expenditure leads to crowd out private investment.
- Businesses face several taxation. Fiscal policy also impacts the amount of taxation on future generations. Government spending that leads to greater difficulties mean taxation will eventually have to increase to pay interest. It impact to the business.

***(03 marks)***

**(E)** The role of government in a market economy (4.7)

1. Distribution of resources efficiently
2. Equitable distribution of income and wealth
3. Establish macroeconomic stability
4. Achievement of Sustainable Development

***(02 marks)***

***(Total 20 marks)***

***End of Section C***

## *Notice:*

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