

FIRST YEAR EXAMINATION IN ARTS
SEMESTER I – 2016

ECN 1103 Principles of Economics

Time Allowed: Two (02) Hours

Answer 03 questions, including question (1) and choosing one more from PART 1 and one from PART 2.

Whenever necessary use rough sketches of graphs to illustrate your answers.

Marks 50 for question (1) and, 25 for each of the other questions.

Calculators can be used.

Answer any 5 of the following questions

The production possibility curve always shows that the more you produce of one commodity, the more you will have to sacrifice of the other commodity. Using a concave curve and hypothetical numbers illustrate this statement. What assumption (type of curve) would you use to falsify the above statement?

Generally economic theory argues that firms would want to employ workers at the lowest possible wage. Efficiency wages on the other hand argues that firms should give wages above the equilibrium wage. What arguments are used to support the paying of efficiency wages?

- The government gives producers a subsidy on raw materials; this increases consumer welfare. Explain using a diagram to illustrate this conclusion.

“An entrepreneur always earns abnormal profit.” Explaining the error in this statement and correct it. Justify why a payment is made to the entrepreneur during the production process.

According to the circular income flow of an economy, production flows, income flows and expenditure flows measure the same thing from different approaches. Explain.

Gross Domestic Product (GDP) of an economy is measured using “value added” concept rather than “gross output” concept. Explain why this is so.

- Some people express their displeasure about the decline in agriculture output share and employment share in Sri Lanka. Do you support or oppose their view? Comment.

- Explain one of the recent economic shocks in the world economy and its possible impact on the macroeconomic performance of Sri Lanka?

(10 marks for each)

(2)

a) Give two reasons why a consumer would buy less of a product when the price goes up. (5 Marks)

b) The demand and supply equation for the market on commodity T is as follows

$$Q_D = 100 - 5P$$

$$Q_S = 10 + 10P$$

i. Find the equilibrium price and quantity. (4 Marks)

ii. Draw a rough diagram showing demand and supply (remember to give the relevant values on your axis). (4 Marks)

iii. Calculate the consumer surplus at equilibrium. (4 Marks)

c) Consider the information given below.

P_x	Q_x	Q_y
5	100	25
10	90	20

i. Calculate the price elasticity of demand for commodity X. Is the demand for this commodity elastic or inelastic? (4 Marks)

ii. Calculate the cross-elasticity of demand for commodity Y. What is the relationship between the two commodities? (4 Marks)

3.

a) What is the difference between disutility and diminishing marginal utility? Explain using examples. (5 Marks)

b) Explain the concept of opportunity cost. Why does opportunity cost occur? (5 Marks)

c) What is the difference between interest rate and real interest rate? If both values are the same, what does it tell us about the economy? (5 Marks)

d) "Land is no longer a scarce factor". Do you agree? Give your views on this statement. (5 Marks)

e) "Minimum wages cause problems in the labour market". Explain. (5 Marks)

(a) What are the uses of estimating national accounts of a country?

(10 Marks)

(b) Estimates of annual national accounts of Sri Lanka for the year 2015 are given below, with all values in Rs. Billion terms:

1	Public Consumption	985
2	Exports of Goods and Services	2295
3	import of Goods and Services	3125
4	Private Consumption	7666
5	Primary Income from rest of the world	17
6	Primary Income to rest of the world	268
7	Gross Domestic Capital Formation	3361
8	Private Saving	2777
9	Public Saving	-246
10	Gross Domestic Product at constant price	8622

Answer the following questions:

- i. Calculate Gross Domestic Product and Gross National Income at market price.
- ii. Calculate Domestic Savings ratio, National Savings ratio and Investment ratio
- iii. What is the value of the GDP deflator in 2015? If GDP deflator for the previous year 2014 was Bn 127 , what is the inflation rate based on the GDP deflator?
(5 marks for each)

(a) Explain why the short-run aggregate supply (SRAS) curve is horizontal and the long-run aggregate supply (LRAS) curve is vertical.

(10 Marks)

(b) Use aggregate demand (AD) and aggregate supply (AS) model to explain short-run and long-run effects of the following changes:

- i. An increase in government expenditure
- ii. Expansionary monetary policy
- iii. An increase in imports

(5 Marks for each)
