

**University of Colombo, Sri Lanka**  
**Faculty of Arts**  
**Bachelor of Arts First Year Examination (Economics)**  
**Second Semester End Examination – 2024/2025**  
**ECN 1202 – Elementary Macroeconomics**  
**Time Allowed: Two (02) hours only**  
**Answer any four (04) questions only.**

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1. US President Donald Trump announced tariffs on imports from about 90 nations on April 2, 2025. These duties included reciprocal 10% general taxes on all imports entering the US. Furthermore, according to the United States, Sri Lanka must pay a 44 percent tax, which is a discounted reciprocal of roughly half of the tariffs and restrictions the island imposes on the United States. However, the effects of these new levies are especially catastrophic for smaller economies like Sri Lanka.
  - i. Briefly discuss what are the immediate challenges faced by the Sri Lankan Economy due to Trump's tariffs (09 Marks)
  - ii. What are the short-term macroeconomic solutions required by Sri Lanka to overcome the adverse effect on exports? (08 Marks)
  - iii. What are the long-term macroeconomic solutions you suggest to mitigate the current turbulent trade environment on Sri Lankan exports? (08 Marks)
2. The government has proposed to increase the cadre and increase the basic salary of the public sector, leading to an increase in public expenditure. In addition, the government increased the transfer payments by proposing pensioners salary hike and an increase in subsidies to those below the poverty line.
  - i. Explain the government expenditure types (05 Marks)
  - ii. What are the government transfer payment types? (05 Marks)
  - iii. If government revenue remains constant, what changes would you expect in GDP growth? (07 Marks)
  - iv. For the sustainability of growth, what changes should take place in other sectors of the economy? (8 Marks)

3. Sri Lanka's has recently implemented fiscal reforms, monetary easing and foreign trade adjustments, highlighting the growing importance of analyzing aggregate economic changes. A clear understanding of how these policy measures and external shocks affect output and price levels in both short run and long run is essential for assessing macroeconomic performance and future policy decisions.
- Explain why the short-run aggregate supply (SRAS) curve is horizontal and the long-run aggregate supply (LRAS) curve is vertical. (10 Marks)
  - Use the aggregate demand (AD) and aggregate supply (AS) model to explain the short-run and long-run effects of the following changes:
    - An increase in government expenditure
    - Expansionary monetary policy
    - An increase in imports
 (5 Marks for each)
4. Sri Lanka has faced challenges in achieving sustained economic growth, with several macroeconomic indicators falling short of optimal levels. Since implementing trade liberalization and market-oriented reforms, country has seen significant challenges in its economic policy. In this period, inflation has been volatile, remaining a persistent challenge to economic stability.
- What is inflation? Briefly explain how it is measured in an economy. (5 Marks)
  - Discuss key causes of inflation. In your answer, explain how each cause impacts the general price level and overall economic stability. (10 Marks)
  - Explain the relationship between money supply growth and inflation. Refer to the Quantity Theory of Money in your answer and discuss whether increasing the money supply always leads to inflation. (10 Marks)
5. The Balance of Payment (BOP) shows a country's economic health by reflecting its transactions with the rest of the world. In Sri Lanka's changes in BOP along with the fluctuations in the exchange rate, have affect economic stability. These changes also create chance to improve economic policies and leading to strong financial stability.

- i. What is the Balance of Payments (BoP)? Briefly explain its two main accounts and its components. (5 marks)
  - ii. What is an exchange rate system? Briefly describe three types of exchange rate systems. (8 Marks)
  - iii. What is the real exchange rate, and how does it differ from the nominal exchange rate? Discuss how changes in the real exchange rate can affect a country's trade balance and overall economy. (12 Marks)
- 6.
- i. Discuss the primary objectives of a Central Bank in a modern economy. Illustrate your answer with relevant examples. (8 Marks)
  - ii. Examine the major functions performed by a Central Bank. How do these functions differentiate the Central Bank from commercial banks? (8 Marks)
  - iii. The Central Bank plays a critical role in maintaining economic stability through its monetary policy tools. Do you agree with the above statement? Explain your answer (9 Marks)
- 7.
- i. Describe the main types of unemployment found in an economy. How do these types of unemployment arise? (8 Marks)
  - ii. Why is high unemployment considered a serious macroeconomic problem? (8 Marks)
  - iii. Critically evaluate the social and economic consequences of unemployment in Sri Lanka. (9 Marks)
8. Write short notes on any **three 3** as of the following
- i. Basic price and market price
  - ii. Real GDP and nominal GDP
  - iii. Physical capital and human capital
  - iv. Treasury Bonds and Treasury Bills
  - v. Types of interest rates
  - vi. Policies to promote investments
  - vii. Labour Market Stocks and Flows (8.33 Marks for each)

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