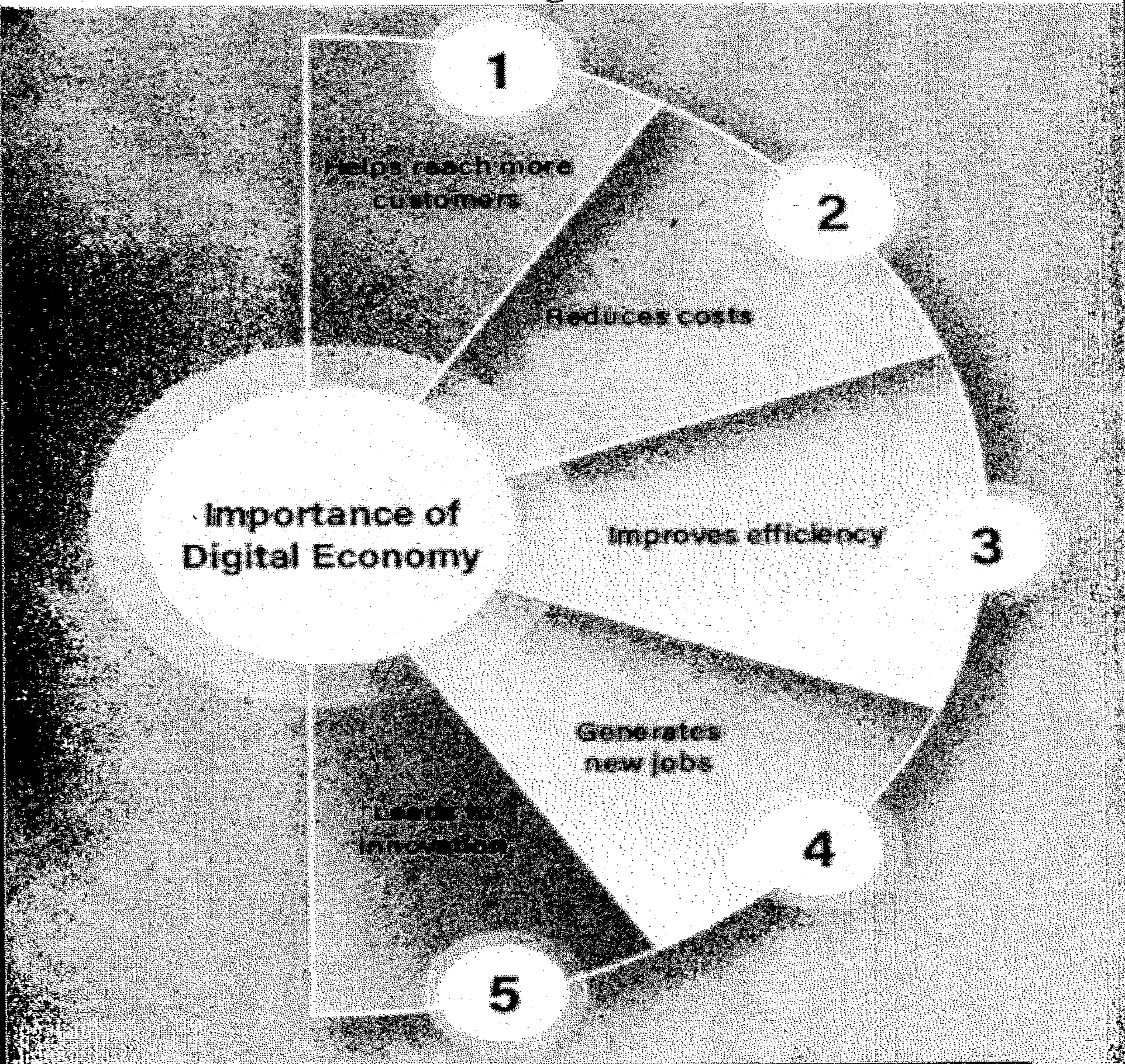
Confidential

Department of Examinations - Sri Lanka
G.C.E. (A/L) Examination - 2024
21 - Economics
Marking Scheme



This has been prepared for the use of marking examiners. Some changes would be made according to the views presented at the Chief Examiners' meeting

Amendements to be included

CONTENTS

Common Techniques of Marking Anser Scripts.

It is compulsory to adhere to the following standard method in marking anser scripts and entering marks into the mark sheets.

1. Use a red color ball point pen for marking. (Only Chief/Additional Chief Examiner may use a mauve color pen.)
2. Note down Examiner's Code Number and initials on the front page of each anser script.
3. Write off an y numerals written wrong with a clear single line and authenticate the alterations with Examiner's initials.
4. Write down marks of each subsection in a △ and write the final marks of each question as a retional number in a ☐ with the question number. Use the column assigned for Examiners to write down marks.

Example : Question No. 03

(i) ....
.... √ $\frac{4}{5}$
....

(ii) ....
.... √ $\frac{3}{5}$
....

(iii) ....
.... √ $\frac{3}{5}$
....

03 (i) $\frac{4}{5}$ + (ii) $\frac{3}{5}$ (iii) $\frac{3}{5}$ = $\boxed{\frac{10}{15}}$

MCQ answer scripts : (Template)

1. Marking templets for G.C.E. (A/L) and GIT examination will be provided by the Department of Examinations itself. Marking examiners bear the responsibility of using correctly prepared and certified templates.
2. Then, check the answer scripts carefully. If there are more than one or no answers Marked to a certain question write off the options with a line. Sometimes candidates may Have erased an option marked previously and selected another option. In such occasions, if the erasure is not clear write off those options too.
3. Place the template on the answer script correctly. Mark the right answers with a '✓' and the wrong ansers with a 'X' against the options column. Write down the number of correct answers inside the cage given under each column. Then, and those numbers and write the number of correct answers in the relevant cage.

Structured essay type and assay type answer scripts :

1. Cross off any pages left blank by candidates. Underline wrong or unsuitable answers. Show areas where marks can be offered with check marks.
2. Use the right margin of the overland paper to write down the marks.
3. Write down the marks given f or each question against the question number in the relevant cage on the front page in two digits. Selection of questions should be in accordance with the instructions given in the question paper. Mark all answers and transfer the marks to the front page, and write off answers with lower marks if extra questions have been answered against instructions.
4. Add the total carefully and write in the relevant cage on the front page. Turn pages of answer script and add all the marks given for all answers again. Check whether that total tallies with the total marks written on the front page.

Preparation of Mark Sheets.

Except for the subjects with a single question paper, final marks to two papers will not be calculated within the evaluation board this time. Therefore, add separate mark sheets for each of the question paper. Write paper 01 marks in the paper 01 column of the mark sheet and write them in words too. Write paper II Marks in the paper II Column and wright the relevant details.

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(21) Economics

STRUCTURE OF QUESTION PAPERS

Paper I - 02 Hours

There are 50 multiple-choice questions and each question has 5 optional answers. All questions are compulsory. Each correct answer is given 01 mark and the total marks will be 50.

Paper II - 03 Hours

This paper consists of two sub-sections.
Sub-section A – 5 structured type questions
Sub-section B – 5 structured type questions
Answer five questions only, selecting minimum of two questions from each sub-section. Each question has 20 marks and the total marks will be 100.

Calculation of the final mark = Paper I 50

= Paper II 100

$$\text{Final mark} = 50 + \left(\frac{100}{2}\right) = 100$$

ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව
இலங்கைப் பரீட்சைத் திணைக்களம்

අ.පො.ස. (උ.පෙළ) විභාගය/ க.பொ.த. (உயர் தர)ப் பரீட்சை - 2024

විෂය අංකය / பாட இலக்கம் **21** විෂයය / பாடம் **ECONOMICS**

ලකුණු දීමේ පටිපාටිය/புள்ளி வழங்கும் திட்டம்

I පත්‍රය/பத்திரம் I

ප්‍රශ්න අංකය வினா இல.	පිළිතුරු අංකය விடை இல.	ප්‍රශ්න අංකය வினா இல.	පිළිතුරු අංකය விடை இல.	ප්‍රශ්න අංකය வினா இல.	පිළිතුරු අංකය விடை இல.	ප්‍රශ්න අංකය வினா இல.	පිළිතුරු අංකය விடை இல.	ප්‍රශ්න අංකය வினா இல.	පිළිතුරු අංකය விடை இல.
01.	2	11.	3	21.	5	31.	1	41.	1
02.	5	12.	3	22.	1	32.	1	42.	2
03.	1/2	13.	4	23.	4	33.	3	43.	1
04.	3	14.	5	24.	4	34.	3	44.	3
05.	2	15.	4	25.	2	35.	1	45.	1
06.	4	16.	5	26.	4	36.	1	46.	3
07.	5	17.	2	27.	4	37.	4	47.	5
08.	2	18.	5	28.	3	38.	5	48.	1
09.	3	19.	1	29.	4	39.	2	49.	5
10.	4	20.	2	30.	2	40.	2	50.	2

✪ විශේෂ උපදෙස්/ விசேட அறிவுறுத்தல்கள் :

එක් පිළිතුරකට/ ஒரு சரியான விடைக்கு 01 ලකුණ බැගින්/புள்ளி வீதம்

මුළු ලකුණු/மொத்தப் புள்ளிகள் 01 x 50 = 50

ශ්‍රී ලංකා විභාග දෙපාර්තමේන්තුව
இலங்கைப் பரீட்சைத் திணைக்களம்
Department of Examinations, Sri Lanka

අධ්‍යයන පොදු සහතික පත්‍ර (උසස් පෙළ) විභාගය, 2024
கல்விப் பொதுத் தராதரப் பத்திர (உயர் தர)ப் பரீட்சை, 2024
General Certificate of Education (Adv. Level) Examination, 2024

ආර්ථික විද්‍යාව II
பொருளியல் II
Economics II

21 E II

ලකුණු දීමේ පටිපාටිය / Marking scheme

පැය තුනයි
மூன்று மணித்தியாலம்
Three hours

අමතර කියවීම් කාලය - මිනිත්තු 10 යි
மேலதிக வாசிப்பு நேரம் - 10 நிமிடங்கள்
Additional Reading Time - 10 minutes

Use additional reading time to go through the question paper, select the questions you will answer and decide which of them you will prioritise.

Instructions:

* *Answer five questions only, selecting minimum of two questions from Sub section 'A' and two questions from Sub section 'B'.*

* *Graph papers will be provided.*

Sub section 'A'

(Select minimum of two questions from this section.)

01

1. (i) Define economic resources and free resources providing two examples of each category. (04 marks)

(ii) Explain the main differences between 'labour' and 'entrepreneurship'. (03 marks)

(iii) Under what conditions would the production possibilities curve be a straight line? (03 marks)

(iv) Compare the role of government in a command economic system and a market economic system. (04 marks)

(v) Explain how market, command and mixed economic systems solve the problem of scarcity and evaluate the effectiveness of those approaches. (06 marks)

1. (i)
- Economic resources are those that are limited in supply and require human effort or capital to obtain or produce.
- These resources have an opportunity cost associated with their use, as their supply is finite relative to the demand for them. **(01 mark)**
- Examples:
  1. Oil 2. Labor 3. Timber **(01 mark)**
- Free resources are those that are abundant in nature and available without the need significant human effort or cost.
- They are typically not owned or traded in markets because their supply exceeds demand at a zero price. **(01 mark)**
- Examples include:
  1. Air 2. Sunlight 3. Gravity **(01 mark)**

(Total marks 04)

(ii) - Labour refers to the physical and mental effort provided by individuals in the production process.
Entrepreneurship is the initiative taken by an individual or a group to organize, manage, and assume the risks of a business. Entrepreneurs coordinate the other factors of production (land, labour, and capital) to produce goods or services.

- Labourers generally have limited responsibility in decision-making and risk-bearing within a business. They work under the direction of managers or entrepreneurs and are usually compensated with fixed wages or salaries.
Entrepreneurs assume a high level of risk in exchange for potential profits. They make strategic decisions, invest capital, and bear the financial risks if the business fails.

- The reward for labour is wages or salaries, paid for the time and effort contributed.
The reward for entrepreneurship is profit, which is the residual income after all costs have been paid.

- Labour may require specific skills or qualifications, but workers are usually trained for repetitive tasks and may follow established procedures.
Entrepreneurship involves creativity, innovation, and risk-taking. Entrepreneurs are often visionaries who seek to create new products or improve existing processes to gain a competitive advantage.

- Labour is generally motivated by job security, wages, and benefits.
Entrepreneurs are often driven by profit potential, autonomy, and a desire to innovate or create something unique.

- Labour contributes to economic growth by providing the workforce needed for production, enabling businesses to function.
Entrepreneurship contributes significantly to economic growth by introducing new products, services, and processes, creating employment opportunities, and fostering competitive markets.

(01 mark each for any three main differences; Total marks 03)

(iii) - Constant Opportunity Cost: When the opportunity cost is constant, it means that for each additional unit of one good produced, a fixed amount of the other good is sacrificed. **(01 mark)**

- Perfect Substitutability of Resources: If resources used in production (such as labor, capital, and materials) are equally efficient in producing both goods, then shifting resources from one good to the other does not change the opportunity cost.

(01 mark)

- Homogeneous Resources: If all resources are homogeneous (i.e., identical in skill, quality, and productivity for the production of both goods), the opportunity cost remains constant as production shifts. This homogeneity eliminates the diminishing returns that usually cause the PPC to bow outward in a more realistic setting.

(01 mark)

(Total marks 03)

(iv) - Control over Resources and Production Decisions:

In a command economy, the government has full control over resources and production decisions. It decides what goods and services are produced, how they are produced, and who receives them. This central planning approach aims to meet national goals rather than respond to individual preferences.

In a market economy, the government generally has a limited role in production decisions. Resources are allocated based on supply and demand, and businesses make production decisions independently to maximize profit. The government intervenes only in cases where markets fail or in sectors deemed essential, like defense or infrastructure.

- Ownership of Resources

In a command economy the government typically owns most, if not all, means of production, such as factories, land, and capital. There is little to no private ownership, and individual entrepreneurship is often restricted or regulated.

In a market economy, most resources are privately owned. Individuals and businesses have the freedom to own, buy, and sell property

Economic Goals and Objectives

In a Command Economy, the government sets and prioritizes national economic goals, such as full employment, price stability, or equitable income distribution. Economic plans are often long-term, focused on achieving social welfare objectives rather than individual profit motives.

In a market economy, economic goals are largely determined by individuals and businesses pursuing their own interests, which collectively drive economic growth, efficiency, and innovation. The government's role is typically to ensure a stable environment, such as enforcing laws, protecting property rights and provision of public goods.

- Pricing Mechanism

In a command economy, prices are set by the government rather than by market forces. In a market economy, Prices are determined by supply and demand, providing signals for producers and consumers to make economic decisions. The government generally does not interfere with pricing, except in specific cases like regulating monopolies or setting minimum wage laws.

- Income Distribution

  In a command economy, income distribution is usually more controlled by the government, aiming to reduce economic inequality. Wages, prices, and social benefits are often set by the government to ensure a more equitable distribution.

  In a market economy, income distribution is generally left to market forces, resulting in a more unequal distribution based on factors like skills, productivity, and investment. The government may intervene through progressive taxation, welfare programs, or subsidies to reduce inequality.

- Role in Innovation and Investment

  In a command economy, investment and innovation are planned by the government, which may allocate funds to specific industries or technologies based on national priorities. In a market economy, innovation and investment are driven by private businesses and entrepreneurs who seek profit.

(01 mark each for any four comparisons; Total marks 04)

(v) Market economy:

Approach to scarcity:

- In a market economy, scarcity is managed primarily through the price mechanism. Resources are allocated based on supply and demand, where prices serve as signals. When a resource or good is scarce, its price rises, which discourages consumption and encourages producers to increase supply. Conversely, if there is an abundance of a resource, its price falls, making it less attractive for production but more accessible to consumers. **(01 mark)**

- Effectiveness:
- Advantages: The market economy is highly efficient at responding to changes in supply and demand. The price mechanism ensures that resources are allocated to their most valued uses, as consumers are willing to pay more for items they value highly, and producers respond accordingly.

- Limitations: A pure market system may not address scarcity in essential goods equitably. Those with higher incomes have greater access to scarce resources, while those with lower incomes may be excluded.

Market economies may also underprovide public goods (like clean air) or struggle to address externalities (such as pollution), which can exacerbate scarcity of clean resources. **(01 mark)**

Command Economy:

- Approach to Scarcity: In a command economy, the government centrally plans and controls resource allocation. Planners decide which goods and services should be produced, in what quantities, and at what prices.
  The government aims to allocate resources in a way that meets national priorities and social needs, rather than relying on individual demand or market signals.
  (01 mark)
- Effectiveness:
- Advantages: Command economies can theoretically ensure that basic needs are met and resources are distributed more equally. By planning production and distribution, the government can focus resources on key industries and allocate resources to provide essential goods and services to everyone, regardless of individual income levels.

- Limitations: Command economies often struggle with inefficiency, as central planning cannot match the dynamic responsiveness of a market system.
  Decisions may be made without regard to actual consumer preferences, leading to shortages (when planners underestimate demand) or surpluses (when they overestimate demand). This rigidity can result in persistent scarcity of some goods, while others may overproduced, wasting valuable resources. **(01 mark)**

Mixed Economy:

- Approach to Scarcity: A mixed economy combines elements of both market and command systems to address scarcity. The government intervenes in the market primarily to provide essential goods and services, regulate certain industries, and ensure equitable access to scarce resources. The private sector, guided by the price mechanism, handles other areas where efficiency and consumer choice are more important.. **(01 mark)**

- Effectiveness:
- Advantages: Mixed economies benefit from the flexibility and efficiency of the market system while allowing government intervention to correct market failures and ensure more equitable distribution. Public goods and services, such as healthcare, education, and environmental protection, are often provided by the government to address scarcity in areas where the market might fail. This system can balance efficiency with social equity.

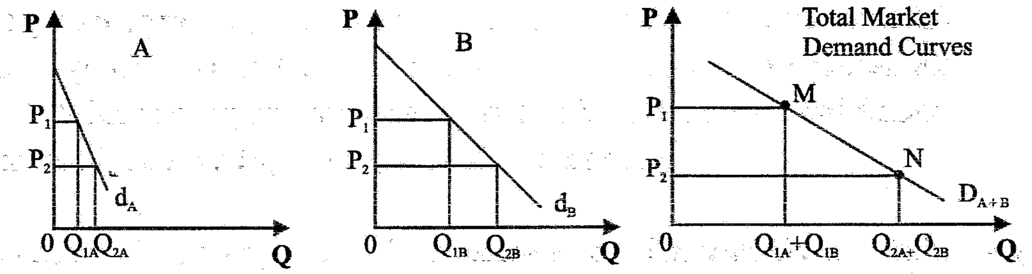
- Limitations: Mixed economies can be complex and may face challenges in striking the right balance between government intervention and market freedom. Too much intervention can stifle innovation and efficiency, while too little can result in inequality and unmet needs. **(01 mark)**

(Total marks 06)

02	
2. (i) Using diagrams, explain how market demand curve is derived from individual demand curves.	(04 marks)
(ii) What is meant by price elasticity of demand? How does it affect total revenue?	(03 marks)
(iii) State three government policy tools which can influence the market supply curve of a commodity.	(03 marks)
(iv) Define the concept of market equilibrium and explain the forces that drive a market disequilibrium towards an equilibrium.	(04 marks)
(v) (a) Define consumer surplus and producer surplus.	(02 marks)
(b) Using diagrams, explain how the price elasticity of demand affects consumer surplus.	(04 marks)

2, (i) - Market demand is the total quantity of a good that all consumers in the market are willing and able to purchase at various prices. It is derived by horizontally summing the individual demand curves. The graph would show individual demand curves being summed horizontally to create the market demand curve, which reflects the aggregate quantity demanded at each price level. **(02 marks)**

Consider a market consisting of two consumers A and B.



At price P_1 above, consumer A demands Q_{1A}, consumer B demands quantity Q_{1B}, and total market demand at that price is $(Q_{1A} + Q_{1B})$, At price P_2, consumer A demands Q_{2A}, and consumer B demands quantity Q_{2B} and total market demand at that price is $(Q_{2A}+Q_{2B})$. D_{A+B} is the total market demand curve. **(02 marks)**

(Total marks 04)

(ii) - Price Elasticity of Demand (PED) measures how responsive the quantity demanded of good or service is to changes in its price. Mathematically, it is calculated as:

$$PED = \frac{\%\text{ Change in Quantity Demanded}}{\%\text{ Change in Price}}$$ **(01 mark)**

- Effect on Total Revenue:
- Elastic Demand (PED > 1):
  When demand is elastic, a decrease in price leads to a proportionally larger increase in quantity demanded, causing total revenue to increase. Conversely, an increase in price causes total revenue to decrease. **(01mark)**

- Inelastic Demand (PED < 1):
  When demand is inelastic, a price increase leads to a smaller decrease in quantity demanded, causing total revenue to increase. A price decrease in this case would result in lower total revenue. **(01 mark)**

(Total marks 04)

(iii) - Subsidies: A subsidy is a financial assistance provided by the government to producers to reduce production costs.

- Taxes (Indirect Taxes): Taxes such as excise duties or value-added tax (VAT) imposed on the production or sale of a commodity.

- Regulations and Standards: Government regulations related to production processes, safety standards, or environmental laws that producers must comply with.

- Government Production and Stockpiling Policies: Governments may directly influence the market supply of certain commodities by either producing the goods themselves (in the case of state-owned enterprises) or by releasing stockpiles of essential commodities (like oil reserves) to stabilize supply in the market.

(01 mark each for any three policy tools; Total marks 03)

(iv) - Market equilibrium refers to a situation where the quantity of a good or service demanded by consumers equals the quantity supplied by producers at a particular price. **(01 mark)**

- At this point, the market is in balance, and there is no tendency for the price to change, as both buyers and sellers are satisfied. **(01 mark)**

- The Forces Driving the Market Toward Equilibrium: The market moves towards equilibrium through the interaction of demand and supply, and the resulting forces of excess supply (surplus) and excess demand (shortage).

- Excess supply occurs when the price of a good is above the equilibrium price, leading to the quantity supplied being greater than the quantity demanded.-Producers are left with unsold goods, creating downward pressure on the price. To clear the surplus, sellers will lower prices, causing an increase in the quantity demanded.

(01 mark)

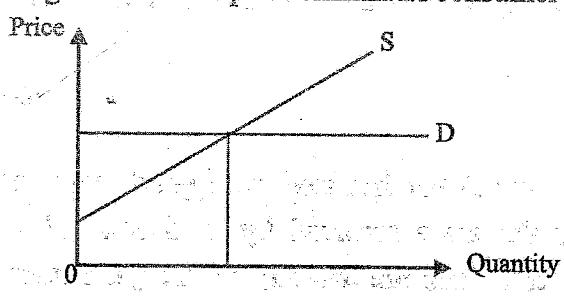
- Excess demand occurs when the price of a good is below the equilibrium price, leading to the quantity demanded being greater than the quantity supplied. Consumers compete for the limited supply, creating upward pressure on the price. Sellers will raise prices, causing a decrease in quantity demanded (as the good becomes more expensive). An increase in quantity supplied (as higher prices incentivize producers to supply more). This process continues until the market price rises to the equilibrium level, eliminating the shortage. **(01 mark)**

(Total marks 04)

(v) (a)- Consumer surplus is the difference between the maximum price a consumer is willing to pay for a good or service and the actual price they pay. **(01 mark)**

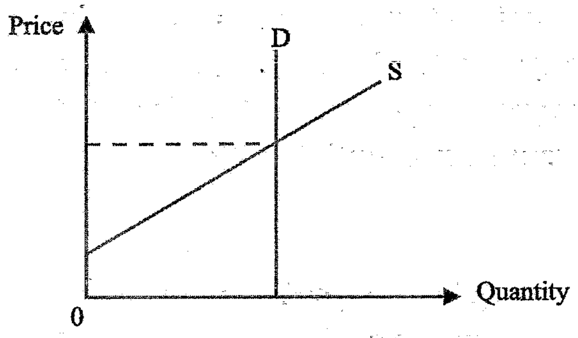
- Producer surplus is the difference between the actual price a producer receives for a good or service and the minimum price they are willing to accept. **(01 mark)**

(b) - Perfectly Elastic Demand (PED = ∞): Consumers are infinitely responsive to price changes, and they buy nothing above a specific price.
Consumer surplus is nearly zero because consumers are only willing to purchase at one specific price.
Even a slight increase in price eliminates consumer surplus entirely. **(01 mark)**



(01 mark)

- Perfectly Inelastic Demand (PED = 0): Quantity demanded does not change regardless of price. Consumer surplus is maximized at any price because consumers are willing to pay any price for the quantity they demand. Price changes only affect the total expenditure, not the quantity consumed. **(01 mark)**



(01 mark)

(Total Marks 04)

03

3. (i) Distinguish between a specific tax and an ad-valorem tax. (02 marks)

(ii) Using diagrams, show the deadweight loss created by a subsidy and a tax in a free market. (04 marks)

(iii) Analyse the impact of maximum price ceilings on consumer surplus, producer surplus, and overall economic welfare. (06 marks)

(iv) Suppose the market demand function for fresh milk is $Q_D = 280 - 2P$ and the market supply function is $Q_S = -220 + 3P$. (Quantities are in million litres and prices are in rupees.)

(a) What are the equilibrium price and the quantity? (02 marks)

(b) Now suppose a subsidy of Rs. 10 is given to the dairy farmers for each litre of fresh milk they produce. What are the new equilibrium price and the quantity? (04 marks)

(c) Do dairy farmers receive total subsidy under this situation? If not, what percentage of the subsidy do dairy farmers actually receive? (02 marks)

3 (i) - A specific tax is a fixed amount of tax imposed on each unit of a good or service.

(01 mark)

- An ad-valorem tax is a percentage of the value or price of a good or service.

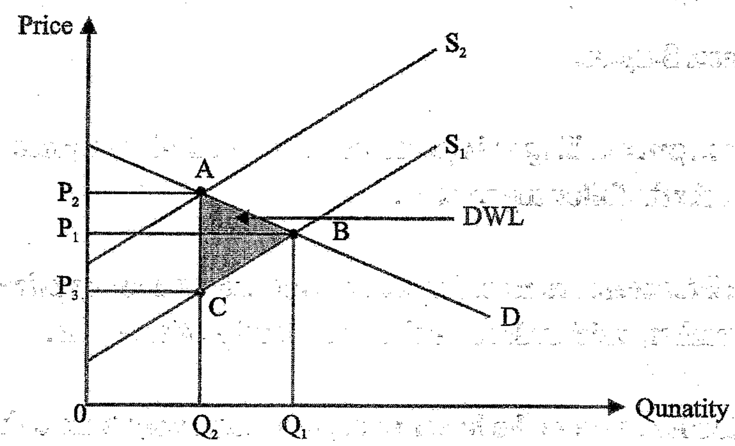
(01 mark)

(Total marks 02)

(ii) - Deadweight Loss from a Tax: A tax imposed on a good increases its price to consumers and decreases the price received by producers. This causes both consumers and producers to reduce the quantity of the good traded, leading to inefficiency.

- Before the tax, the market is in equilibrium at price P1 and quantity Q1, where demand equals supply. After Tax is Imposed, the price that consumers pay rises to P2, and the price that producers receive falls to P3. The new quantity traded in the market is reduced to Q2.

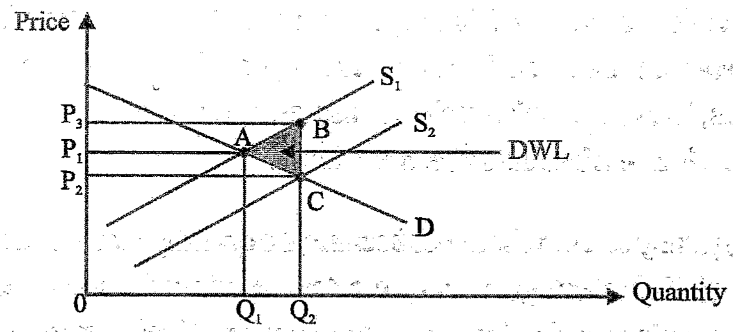
- The triangle between the original and new quantity Q1 and Q2, bordered by the demand curve and the supply curve, represents the deadweight loss (DWL) due to the tax. This area reflects the loss in economic welfare because fewer transactions occur due to the tax.



(02 marks)

- Deadweight Loss from a Subsidy: A subsidy lowers the price consumers pay and increases the price producers receive, encouraging more production and consumption than the market equilibrium would support. This results in inefficiency because the extra consumption and production are valued less than their cost.

- Before the subsidy, the market is at equilibrium at price P1 and quantity Q1. After the subsidy is imposed, consumers pay a lower price P2 and producers receive a higher price P3 due to the subsidy. The new quantity traded increases to Q2 above the equilibrium quantity Q1. The triangle between the original equilibrium quantity Q1 and the new quantity Q2, bordered by the demand curve and the supply curve, represents the deadweight loss (DWL) of the subsidy. This area reflects the inefficient overproduction and overconsumption that the subsidy encourages.



(02 marks)

(Total marks 04)

(iii) - Impact on Consumer Surplus:

- When a maximum price is set below the equilibrium price, it allows consumers to buy the product at a lower price, which increases consumer surplus.

- However, a price ceiling typically leads to a shortage because the quantity demanded exceeds the quantity supplied. This means some consumers who would have been willing to pay the equilibrium price might not be able to obtain the good at all, which reduces consumer surplus for them. **(02 marks)**

- Impact on Producer Surplus:

- When a maximum price ceiling is imposed below the equilibrium price, it reduces producer surplus for the following reasons:

- Lower revenue: Producers are forced to sell the product at a lower price than they would in a free market, which reduces their revenue and profit margins.

- Decreased production: Due to the lower price, producers may reduce the quantity supplied, either because producing at the ceiling price becomes less profitable or because it results in losses. This further decreases producer surplus.

- Exit from the market: Some producers may find it unsustainable to continue production at the lower price, leading them to exit the market altogether.

(02 marks)

- Impact on Overall Economic Welfare:
- Under normal market conditions, price ceilings may increase consumer surplus as it allows consumer to buy at a price lower than the equilibrium price. However, the consumer surplus may fall if demand were sufficiently price inelastic.

- A lower producer surplus as the volume of trade contracts at the low prices.

- A maximum price ceiling creates inefficiency in the market by preventing the price from reaching its equilibrium level. The quantity supplied falls, while the quantity demanded increases, leading to a mismatch between supply and demand. This results in deadweight loss, which is a loss of total economic welfare.

- The price ceiling typically leads to shortages because the quantity demanded exceeds the quantity supplied. This shortage not only creates a deadweight loss but can also lead to non-price rationing mechanisms (e.g., long queues, black markets), further reducing overall welfare. **(02 marks)**

(Total marks 06)

(iv) (a) - Market equilibrium for fresh milk: $Q_D = Q_S$

$Q_D = 280 - 2P$ $\qquad$ $Q_S = -220 + 3P$

$280 - 2P = -220 + 3P$

$500 = 5P$ $\qquad$ Equilibrium price = Rs. 100 per litre **(01 mark)**

Equilibrium quantity $= 280 - 2\ (100) = 280 - 200 = 80$ (million litres) **(01 mark)**

(b) The new equilibrium price after the subsidy of Rs. 10 per litre:

$Q_D = Q_{s1}$

$280 - 2P = -220 + 3(P+10)$ **(01 mark)**

$280 - 2P = -220 + 3P + 30$

$280 - 2P = -190 + 3P$

$470 = 5P$

$94 = P$ New equilibrium price = Rs. 94 per litre **(01 mark)**

New equilibrium quantity $= 280 - 2(94)$

$= 280 - 188 = 92$ (million litres) **(02 marks)**

(c)
- Dairy farmers do not receive the entire subsidy
- Before the subsidy farmers received Rs 100 per litre
- After the subsidy farmers received Rs 104 (94 + 10) per litre
- Subsidy per litre is Rs. 10; But farmers receive only Rs. 4 per litre
- Percentage of the subsidy received by the dairy farmers $= 4/10 = 40\%$

(02 marks)

(Total marks 08)

04

4. (i) Define the Law of Diminishing Marginal Returns in the context of a short-run production function. (02 marks)
   (ii) How does a firm determine its profit-maximizing level of output in the short-run production process? (03 marks)
   (iii) During a production period, a firm earns Rs. 200,000 in total revenue and incurs Rs. 150,000 in explicit costs. The firm's implicit costs including the opportunity cost of the owner's capital and labour amount to Rs. 70,000.
   Calculate the firm's accounting profit and economic profit. (04 marks)
   (iv) Explain how a shift in the firm's cost structure such as an increase in the cost of raw materials would affect the firm's short-run supply curve and the overall industry supply curve. Use appropriate diagrams to support your explanation. (05 marks)
   (v) A perfectly competitive firm sells its output at a market price of Rs. 120 per unit. The firm's average fixed cost is Rs. 20 and the average variable cost is Rs. 80, when 60 units are produced.
   (a) Calculate the firm's total revenue, total cost and economic profit or loss at this level of output. (04 marks)
   (b) Calculate the producer surplus at that level of output. (02 marks)

4. (i) - The Law of Diminishing Marginal Returns states that, in the short run, as additional units of a variable input (such as labor) are added to a fixed input (such as capital or land), the marginal product of each additional unit of the variable input will eventually decline, assuming all other factors remain constant **(02 marks)**

(ii) The profit-maximizing level of output occurs where MR = MC. **(01 mark)**

- Marginal Revenue (MR) is the additional revenue a firm earns by selling one more unit of output. Marginal cost is the additional cost of producing one more unit of output. The firm will increase production as long as MR exceeds MC, since it adds more to revenue than to cost. However, if MR is less than MC, producing additional units would decrease profit. Therefore, the optimal point is where MR = MC. This is the fundamental condition for profit maximization. **(01 mark)**

- MC must be rising at the profit-maximizing output: It's not enough for MR to equal MC; marginal cost must be rising, not falling, to ensure that increasing output beyond this point would result in higher costs than revenues, decreasing profit.

(01 mark)

(Total marks 03)

OR

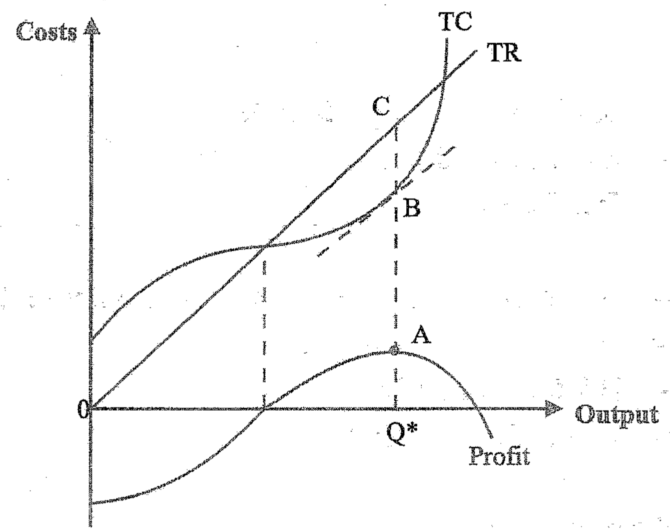
- Total Revenue and Total Cost Approach:
  Alternatively, a firm can compare total revenue (TR) and total cost (TC) directly.
  Profit is calculated as: TR – TC
  By comparing TR and TC at different levels of output, the largest positive difference

between TR and TC can be identified as the profit maximizing level of output.

(03 marks)

OR

- Profit maximizing level of output can be determined graphically.



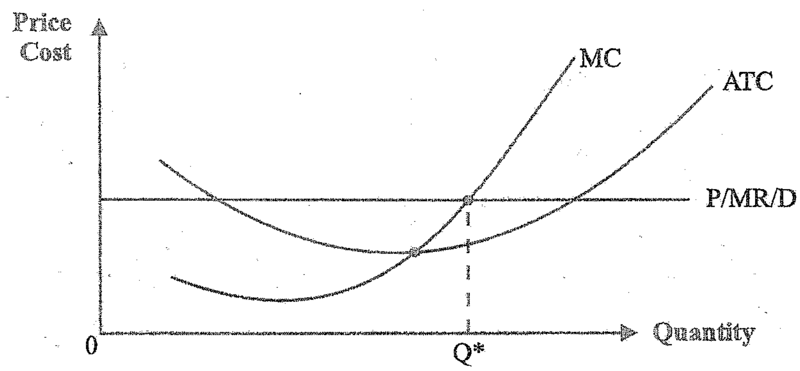
One method of finding the profit maximizing output is study the firm's total revenue and total cost curves and find the output level at which total revenue exceeds total cost by the largest amount. Economic profit is measured by the vertical distance between the TR and TC curves. At the output level Q*, the vertical distance between TR and TC curves is at its largest.

The firm maximizes profit at the output level where the vertical distance between TR and TC is the greatest. or where the slope of TR equals the slope of TC, which is again where MR = MC. **(03 marks)**

OR

The other graphical method of finding profit maximizing level of output is to use marginal analysis and compare marginal revenue (MR) with marginal cost (MC).

Profit-maximizing level of output



As output increases, marginal revenue remains constant but marginal cost changes. 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 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. When MR = MC economic profit is maximized. It occurs at output level Q*. **(03 marks)**

(iii) - Accounting Profit = Total Revenue – Explicit Costs **(01 mark)**

$= 200,000 - 150,000$

$=$ Rs. $50,000$ **(01 mark)**

- Economic Profit = Total revenue – (Explicit Costs + Implicit Costs) **(01 mark)**

$= 200,000 - (150,000 + 70,000)$

$= 200,000 - 220,000)$

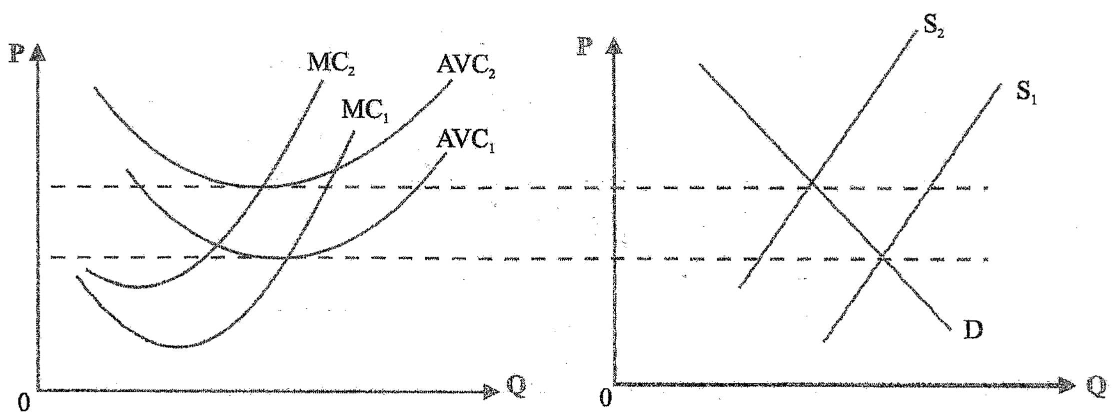
$=$ Rs. $-20,000$ (a Loss) **(01 mark)**

(Total marks 04)

(iv) - Effect on the Firm's Supply Curve:

The firm's supply curve shows the relationship between the price of the good and the quantity the firm is willing to supply at different prices. An increase in the cost of raw materials leads to higher production costs (AVC and MC) at every level of output. Since the firm is now less profitable at each price level, it will reduce the quantity it is willing to supply at any given price. As a result, the firm's supply curve shifts upward (or to the left) because the firm will only supply the same quantity of goods at a higher price. **(02 marks)**

- The industry supply curve is the horizontal sum of all individual firms' supply curves. If many firms in the industry face the same increase in raw material costs, the individual firms' supply curves will all shift upward or to the left. This will lead to an overall leftward shift of the industry supply curve, as firms in the industry collectively reduce their output at each price level. **(01 mark)**



(02 marks for the correct diagrams)

(Total marks 05)

(v) (a) - Market price per unit: Rs. 120

- Total Revenue (TR) = Price per unit × Quantity of output
- TR = 120×60 = Rs. 7200 **(01 mark)**

- Total Cost (TC): TC = TFC + TVC

  TC = 1200 + 4800 = Rs. 6000 **(01 mark)**

- Economic Profit or Loss:

  Profit/Loss = TR – TC

  Profit/Loss = 7200 – 6000 = Rs.1200

  The firm is earning an economic profit of Rs. 1200 at this level of output.

(02 marks)

(Total marks 04)

(b) - Producer surplus at the output level of 60units:

- Producer surplus = Total Revenue – Total Variable Cost **(01 mark)**

Total Revenue	=	7200
Total Variable Cost	=	AVC x Q = 80 x 60 = 4800
Producer Surplus	=	7200 – 4800 = 2400
	=	Rs. 2400

(01 mark)

(Total marks 02)

05

5. (i) Name the leakages in the circular flow of income model for an open economy. (03 marks)

(ii) What activities are excluded within the production boundary in the System of National Accounts? (03 marks)

(iii) State whether the following statements are true or false and explain the reasons for your answer.

(a) The production of goods for own consumption such as subsistence farming is included within the production boundary.

(b) The 'rest of the world' is considered as an institutional unit in the System of National Accounts.

(c) Vehicle registration fees paid by business firms are part of 'other taxes on production'.

(d) Barter transactions are not included in the production boundary because no money is exchanged.

(e) 'Taxes on product' only apply to taxes directly imposed on the quantity of goods produced. (01 × 5 = 05 marks)

(iv) Consider a closed economy where the autonomous consumption is Rs. 200 billion, the marginal propensity to consume is 80% of disposable income and investment is Rs.500 billion. Further the Government spending is Rs.300 billion and autonomous taxes are Rs. 200 billion.

Calculate the equilibrium level of national income of this economy. (04 marks)

(v) (a) Define 'recessionary gap' and illustrate it in an aggregate demand-supply model. (03 marks)

(b) What policy recommendations would you suggest to bring an economy towards full employment level by eliminating a recessionary gap? (02 marks)

5. (i) - Savings (S):
Taxes (T)
Imports (M) **(01 mark each; Total marks 03)**

(ii) - Unpaid Domestic Work:
Housework and care services provided by household members for their own consumption (e.g., cooking, cleaning, child-rearing, caring for children, the sick and aged, educating children, maintenance and repair of dwellings and durables, transportation of household members etc. are excluded.)

- Volunteer Work:
Unpaid volunteer services provided to non-market institutions (such as charities) or other households.

- Transfer Payments:
Government transfer payments, such as pensions, unemployment benefits, and social security. .

- Purely Financial Transactions:

Activities like buying and selling of financial assets (stocks, bonds, etc.) or simple transfers of ownership are excluded.

- Marketing of second hand goods

- Purely natural production processes without any human involvement or direction. For example, the unmanaged growth of fish stocks in international waters is not production.

(01 mark each for any three activities; Total marks 03)

(iii) (a) - True.

- Subsistence farming is included because it involves the production of goods (such as crops or livestock) that have market value, even if they are consumed by the producer's household and not sold. This is a form of productive activity that can be quantified in monetary terms.

(b) - True

- This unit records all economic transactions between residents of a country and non-residents. It includes international trade, cross-border investments, and income flows sent or received from abroad. These transactions are critical for calculating the Balance of Payments and GNI in an open economy.

(c) - True.

- Vehicle registration fees paid by businesses are considered art of "other taxes on production" because these are non-product-specific taxes that are incurred during the production process but are not directly linked to the output itself.

(d) - False.

- Barter transactions are included within the production boundary in national accounts, despite the absence of monetary exchange. The production boundary includes all economic activities that result in the production of goods and services, whether they involve monetary transactions or not.

(e) - False.

- Taxes on product are not solely limited to those that are directly tied to the quantity of goods produced. There are different types of product-related taxes, (excise tax, sales tax, value-added tax) and they can be based on various factors, including the price, value, and specific characteristics of the goods, not just on the quantity of goods produced.

(01 x 05 = 05 marks)

(iv) The equilibrium level of national income:

$Y = C+I+G$ **(01 mark)**

$C = C_0+MPC\times(Y_d)$ **(01 mark)**

$Y = 200+0.8(Y-T)+500+300$

$Y=200+0.8(Y-200)+500+300$ **(01 mark)**

$Y=200+0.8Y-160+500+300$

$Y=0.8Y+1000-160$

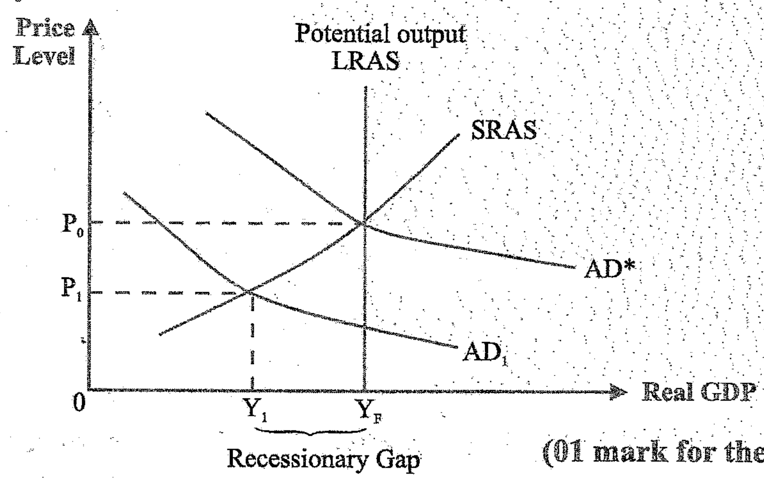
$Y-0.8Y=840$

$Y=4200$ (Rs. Billion) **(01 mark)**

(Total marks 04)

(v) (a) - A recessionary gap is the difference between an economy's potential output (also known as full-employment output) and its actual output when the actual output is less than the potential output. **(02 marks)**

The concept of recessionary gap is illustrated in the aggregate demand-aggregate supply model as shown below:



(01 mark for the correct diagram)

(03 marks)

(b) To bring an economy towards full employment and eliminate a recessionary gap, policymakers typically focus on stimulating aggregate demand, addressing structural issues, and providing support to key sectors of the economy.

- Expansionary Fiscal Policy
  - Increase Government Spending
  - Cut Taxes
  - Unemployment Benefits and Social Welfare Programs

- Expansionary Monetary Policy
  - Lower Interest Rates
  - Quantitative Easing (QE)

- Labor Market Policies
  - Job Training and Education Programs
  - Wage Subsidies and Hiring Incentives
  - Reducing Labor Market Rigidities

- Support for Business Investment
  - Tax Incentives for Investment
  - Support for Small and Medium-Sized Enterprises (SMEs)
  - Stimulating Innovation and Entrepreneurship.

- Trade and Export Policies
  - Export Promotion
  - Addressing Trade Barriers

- Addressing Inflation Concerns
  - Inflation Control Measures

- Structural Reforms
  - Productivity Enhancements (investment in technology)
  - digital infrastructure
  - Regulatory Reforms

(01 mark each for any two policy recommendations; 02 marks)

(Total marks 05)

Sub section 'B'

(Select minimum of two questions from this section.)

06	
6. (i) Name three money aggregates widely used in the context of Sri Lanka's monetary policy.	(03 marks)
(ii) What factors have contributed Sri Lanka's inflation to be contained at single-digit level since the end of 2023 from its peak levels of around 70% recorded in September 2022?	(04 marks)
(iii) Explain why policymakers focus on core inflation rather than headline inflation in setting monetary policy.	(04 marks)
(iv) What would be the impact of an increase in the statutory reserve ratio on the money supply and the banking system's ability to create money?	(04 marks)
(v) Explain the concept of interest rate corridor and analyse its role in monetary policy in Sri Lanka.	(05 marks)

6 (i) Widely money aggregates in Sri Lanka:
- Reserve Money (M0)
- Narrow Money (M1)
- Consolidated Broad Money (M2b)

(01 mark each for the three aggregates; Total marks 03)

(ii) Factors contributed to Sri Lanka's inflation being contained at single-digit levels:
- Tight Monetary Policy: The Central Bank of Sri Lanka (CBSL) implemented a series of interest rate hikes and maintained a tight monetary stance.

- Stabilization of Exchange Rate: After experiencing a sharp depreciation in 2022, the Sri Lankan rupee stabilized, supported by measures such as import restrictions and improvements in the balance of payments. This stabilization reduced imported inflation.

- Improved Fiscal Discipline: The Sri Lankan government adopted fiscal consolidation measures, including reducing the budget deficit and enhancing revenue collection. The implementation of the IMF-supported program in 2023 helped reduce fiscal imbalances, curbing inflationary pressures.

- Supply Chain Normalization: As global supply chains gradually recovered from disruptions caused by the COVID-19 pandemic and the Russia-Ukraine war, the cost of imported goods, including food and fuel, began to stabilize.

- Reduction in Global Commodity Prices: The moderation of global oil and food prices since mid-2023 played a key role in reducing cost-push inflation in Sri Lanka.

- Implementation of Structural Reforms: Reforms aimed at improving the country's macroeconomic stability, including debt restructuring and improvements in governance, helped restore investor confidence and economic stability. These efforts contributed to controlling inflationary expectations in the country.

- External Financial Support : The IMF and other international financial institutions provided financial assistance, which helped stabilize the economy and the exchange rate.

(01 mark each for any four factors; Total marks 04)

(iii) - Policy makers focus on core inflation rather than headline inflation in setting monetary policy because core inflation provides a more stable and reliable measure of underlying inflationary trends. By focusing on core inflation, policy makers can make better- informed decisions that target the long-term inflationary pressures in the economy.

- Excludes Temporary Volatility: Headline inflation includes all items in the consumer price index (CPI), including food and energy prices, which are subject to short-term volatility due to factors like seasonal effects, global supply shocks, and weather conditions.
  Core inflation, on the other hand, removes these volatile components, providing a more accurate reflection of the underlying and persistent inflation trends. This allows policymakers to avoid overreacting to temporary price changes that do not reflect fundamental inflationary pressures.

- Better Indicator of Long-Term Inflation Trends: By focusing on the less volatile components of the inflation basket, it gives a clearer picture of the long-term inflationary pressures stemming from demand-side factors. Headline inflation, because of its sensitivity to price shocks, can lead to misleading signals about the true inflationary environment.

- Prevents Premature or Unnecessary Policy Adjustments: If policymakers respond to temporary spikes in headline inflation caused by factors like oil price surges or natural disasters, they may tighten or loosen monetary policy prematurely, leading to unnecessary economic disruption. Focusing on core inflation helps avoid reacting to short-term fluctuations.

- More Relevant for Managing Inflation Expectations: One of the key objectives of monetary policy is to manage inflation expectations. Core inflation is more representative of the price changes that persist over time and can help anchor inflation expectations more effectively.

- Monetary Policy is Less Effective in Controlling Supply-Side Shock: Headline inflation is often affected by supply-side shocks, such as spikes in global oil prices or agricultural disruptions. Since monetary policy primarily influences demand-side factors, it is less effective in controlling such supply- driven price increases. Policymakers prefer core inflation because it is more closely tied to factors that monetary policy can influence, such as domestic consumption, investment, and interest rates.

(01 mark each for any four reason; Total marks 04)

(iv) - When the central bank increases the SRR, commercial banks are required to keep a higher proportion of their deposits in reserve, rather than using that money to make loans or create new deposits. This change leads to a reduction in the money supply in the economy for several reasons: **(01 mark)**

- Reduction in Lending Capacity: With a higher SRR, banks have less money available to lend out to borrowers. Loans are a major mechanism through which money supply increases. Now the ability to expand money supply through lending is restricted. **(01 mark)**

- Lower Money Creation: The money multiplier effect is reduced. The money multiplier is the ratio of the amount of money the banking system can create with each unit of reserve. A higher SRR reduces this multiplier, meaning each unit of reserve can support fewer loans and thus a lower total money supply. **(01 mark)**

- The money multiplier is calculated as

$$\text{Money Multiplier} = \frac{1}{\text{SRR}}$$

It is inversely related to the SRR. If the SRR increases, the money multiplier decreases. This means that for every unit of reserves, the amount of money that can be created through the banking system decreases. As a result, the overall money supply contracts. **(01 mark)**

(Total marks 04)

(v) - The Interest Rate Corridor (IRC) is a key monetary policy tool used by the Central Bank of Sri Lanka (CBSL) to influence short-term interest rates and guide the overall monetary policy stance. The IRC consists of two main components: the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR). These rates create a "corridor" within which short-term market interest rates, such as the overnight interbank rate, fluctuate. **(01 mark)**

- Influence on Short-Term Market Rates:
  The main objective of the IRC is to steer short-term interest rates, particularly the overnight interbank rate (the rate at which banks lend to each other overnight). This rate is crucial because it influences other interest rates in the economy, such as lending rates, deposit rates, and bond yields.
  The CBSL uses the SDFR and SLFR to maintain the overnight interbank rate within the desired range, helping control liquidity in the financial system. **(01 mark)**

- Transmission of Monetary Policy:
  By adjusting the SDFR and SLFR, the CBSL influences overall monetary conditions. For example, if the CBSL wants to stimulate economic activity, it may lower both the SDFR and SLFR, thereby reducing the cost of borrowing and encouraging banks to lend more.
  Conversely, to curb inflation, the CBSL may raise these rates, increasing the cost of borrowing and reducing excess liquidity. This adjustment helps the central bank transmit its monetary policy stance to the broader economy. **(01 mark)**

- Control of Inflation:
  The IRC plays a significant role in inflation targeting. By influencing short-term interest rates, the CBSL can indirectly control inflationary pressures. For instance, in times of high inflation, increasing the SLFR discourages borrowing and spending, helping cool down demand and contain price rises. **(01 mark)**

- Liquidity Management:
  The IRC also aids in managing liquidity in the banking system. When there is excess liquidity, banks are likely to deposit funds at the SDFR, which absorbs surplus liquidity. On the other hand, when there is a liquidity shortage, banks may borrow at the SLFR, injecting liquidity into the system. **(01 mark)**

(Total marks 05)

07

7. (i) Define 'common property resources' and distinguish them from public goods. (04 marks)

(ii) Name **three** sources of multilateral lending to Sri Lanka. (03 marks)

(iii) Explain how market failure and government failure can lead to inefficiency in the allocation of resources of a country. (05 marks)

(iv) The table below shows some selected public finance data for a hypothetical economy in year 2022.

Item	Value (Rs. billion)	Item	Value (Rs. billion)
Tax Revenue	1 800	Current Transfers and Subsidies	800
Non Tax Revenue	250	Capital Expenditure	1 000
Grants	50	Net Lending	200
Expenditure on Goods and Services	1 200	Amortization Payments	1 400
Interest Payments	1 500		

Calculate the following pertaining to the government budget using the above information.

(a) Current account balance

(b) Primary account balance

(c) Overall balance

(d) Gross financing needs (02 × 4 = 08 marks)

7. (i) - Common property resources are resources that are shared by a group of individuals and are rivalrous in nature but non-excludable. These resources can be accessed and used by multiple people, but one person's use of the resource diminishes its availability for others. This often leads to problems like overuse and depletion, a situation known as the tragedy of the commons.

Examples: Fisheries, forests, grazing lands, water bodies, and atmospheric resources like clean air. **(02 marks)**

- Public goods are goods that are non-rivalrous and non-excludable, meaning that one person's consumption of the good does not reduce its availability to others, and it is not feasible or efficient to exclude anyone from using the good.

Examples: National defense, street lighting, and clean air

(02 marks)

(Total marks 04)

OR

Key Differences Between Common Property Resources and Public Goods:

Feature	Common Property Resources	Public Goods
Rivalry	Rivalrous: One person's use reduces availability for others.	Non-Rivalrous : One person's use does not reduce availability for others.
Excludability	Non-Excludable: Difficult or costly to exclude others from use.	Non-Excludable : Impossible or inefficient to exclude others from use.
Consumption Effect	Overuse can lead to depleation or degradation (e.g. over fishing, deforestation).	Non depletion from use (e.g. national defense benefits everyone equally).
Examples	Fisheries, forests, grazing lands, fresh water.	National defense, public health measures, street lighting.

(04 marks)

(ii) Sources of multilateral lending:

- Asian Development Bank (ADB)

  Asian Infrastructure Investment Bank (AIIB)

  European Investment Bank (EIB)

  International Fund for Agricultural Development (IFAD)

  International Monetary Fund

  Nordic Development Fund (NDF)

  OPEC fund for International Development (OFID)

  World Bank **(01 mark for each source; Total marks 03)**

(iii) - Market failure occurs when the free market, operating without government intervention, fails to allocate resources efficiently. This leads to outcomes where the quantity goods and services produced and consumed is either too high or too low compared to the socially optimal level.

- Public Goods: Public goods cannot be provided efficiently by the market individuals who do not pay cannot be excluded from using them. Market system does not allocate resources to produce public goods

- Externalities: Negative externalities (e.g., pollution) occur when the full social costs of good are not reflected in its price, leading to over-production. Positive externalities (e.g., education) occur when the benefits extend beyond the individual, leading to under-production. In both cases, resource allocation is inefficient.

- Imperfect Competition: Markets may fail due to monopoly power, oligopoly, or monopolistic competition. In these cases, firms can restrict output and charge higher prices, resulting in underproduction and higher prices, reducing consumer welfare.The monopoly or oligopoly restricts supply to maximize profits, leading to a misallocation of resources where less is produced than is socially optimal.

- Asymmetric Information: When one party in a transaction has more or better information than the other, it can lead to adverse selection or moral hazard, where markets fail to operate efficiently.

(01 mark each for any three causes of market failure; 03 marks)

- Government Failure: Government failure occurs when government intervention in the market, intended to correct market failure, creates inefficiencies itself or makes the situation worse.

- Regulatory Capture: When regulators act in the interest of the industry they are supposed regulate, rather than the public interest, policies may favor certain businesses over consumers, leading to a misallocation of resources. This happens when industries influence regulations to protect their interests rather than promoting competition or efficiency.

- Inadequate or Excessive Regulation: Sometimes, government regulation can be too stringent or too lax. Overregulation can lead to high compliance costs for businesses, reducing competition and innovation, and leading to inefficiencies. For example, excessive environmental regulations may stifle economic activity, while too little regulation may result in resource depletion or environmental damage

- Distortionary Taxes and Subsidies: While taxes and subsidies are meant to correct market failures (such as taxing pollution or subsidizing renewable energy), they can be misused or poorly designed. Subsidies can lead to overproduction in certain sectors (e.g., agriculture subsidies leading to overproduction of certain crops), while taxes can distort prices, discouraging production and consumption of goods that might otherwise be beneficial to society.

- Bureaucratic Inefficiency: Governments can also fail due to inefficiencies in bureaucracy. Public sector inefficiencies, such as slow decision-making, lack of accountability, or wasteful spending, can lead to resources being allocated poorly, resulting in inefficiency and a failure to meet societal needs.

- Political Incentives: Government decisions may be influenced by short-term political interests rather than long-term societal welfare. Politicians may implement popular but economically inefficient policies, such as price controls or protectionist measures, which distort market signals and lead to misallocation of resources.

- Rent-Seeking Behavior: Government failure can also occur when businesses or interest groups engage in rent-seeking—lobbying for favorable policies that benefit them at the expense of society. This can lead to overinvestment in unproductive sectors or misallocation of resources to politically connected industries, rather than those that contribute most to economic efficiency.

(01 mark each for any two causes of government failure; 02 marks)

(Total marks 05)

(iv) (a) Current account balance = (Tax Revenue + Non=Tax Revenue) - (Expenditure on Goods and Services + Current Transfers and Subsidies + Interest Payments)

$$=(1800+250) - (1200+800+1500)$$

$$= 2050-3500 = -1450$$

(b) Primary account balance = (Tax Revenue + Non=Tax Revenue + Grants) - (Recurrent Expenditure without Interest payments + Capital Expenditure + Net Lending)

$$= (1800+250+50) - (3500-1500+1000+200)$$

$$= 2100 - 3200 = -1100$$

(c) Overall Balance = (Total Revenue + Grants) – (Recurrent Expenditure + Capital Expenditure)

$$= (1800+250+50) - (1200+800+1500+1000+200)$$

$$= 2100-4700 = - 2600$$

(d) Gross financing Needs = Overall Budget Deficit + Amortization Payment

$$= 2600 + 1400 = 4000$$

(02 marks x 4 = 08 marks)

08

8. (i) Suppose country A can produce 10 units of textiles or 5 pairs of shoes with one unit of labour, while country B can produce 15 units of textiles or 10 pairs of shoes with one unit of labour.
   (a) Explain which country has a comparative advantage in the production of each good. (04 marks)
   (b) Determine the range of possible terms of trade between textiles and shoes for a mutually beneficial trade to occur. (02 marks)
(ii) What are the main causes of persistent trade deficit Sri Lanka has faced after 1977? (04 marks)
(iii) What measures can be taken to enhance Sri Lanka's export competitiveness in the global market? (04 marks)
(iv) What are the main macroeconomic effects associated with a depreciation of the external value of the currency? (06 marks)

8. (i) (a) - In Country A, the opportunity cost of 1 unit of textile is 5/10 = 0.5 pairs of shoes (i.e., producing 1 unit of textile costs 0.5 pairs of shoes).

- In Country B, the opportunity cost of 1 unit of textile is 10/15 = 0.67 pairs of shoes (i.e., producing 1 unit of textile costs about 0.67 pairs of shoes). **(01 mark)**

- Country A has a lower opportunity cost for producing textiles (0.5 pair of shoes) compared to Country B (0.67 pair of shoes).
  Therefore, Country A has a comparative advantage in textiles. **(01 mark)**

- In country A, the opportunity cost of 1 pair of shoes is 10/5=2 units of textiles (i.e., producing 1 pair of shoes costs 2 units of textile).

- In country B, the opportunity cost of 1 pair of shoes is 15/10 = 1.5 units of textiles (i.e., producing 1 pair of shoes costs 1.5 units of textiles). **(01 mark)**

- Country B has a lower opportunity cost for producing shoes (1.5 textiles) compared to country A (2 textiles).
  Therefore, Country B has a comparative advantage in producing shoes.

(01 mark)

(Total marks 04)

(b) Range of Possible Terms of Trade

For mutually beneficial trade to occur, the terms of trade must lie between the opportunity costs of producing each good in both countries.

- The terms of trade for 1 unit of textiles:
  Country A's opportunity cost of 1 unit of textile is 0.5 pairs of shoes

Country B's opportunity cost of 1 unit of textile is 0.67 pairs of shoes.
Thus, the terms of trade for 1 unit of textile should be between 0.5 and 0.67 pairs of shoes. **(01 mark)**

- The terms of trade for 1 pair of shoes:
  Country A's opportunity cost of 1 pair of shoes is 2 units of textiles.
  Country B's opportunity cost of 1 pair of shoes is 1.5 units of textiles.
  Thus, the terms of trade for 1 pair of shoes should be between 1.5 and 2 units of Textiles **(01 mark)**

(Total marks 06)

(ii) The main causes of persistent trade deficits :

- Dependence on primary commodity exports

- Limited Export Base

- Vulnerability to Global Prices

- High Import Dependence

- Import of Essential Goods: Sri Lanka is highly dependent on imports for essential goods, including petroleum products, machinery, intermediate goods, and foodstuffs like wheat and sugar.

- Weak Industrial Export Sector

- Slow Industrialization: Unlike East Asian economies that successfully transitioned to export-led industrialization, Sri Lanka's industrial sector remained underdeveloped for decades.

- Limited Innovation and Productivity
- Overvalued Exchange Rate: At various times, Sri Lanka maintained an overvalued exchange rate, making imports cheaper but negatively affecting export competitiveness.

Rising Domestic Demand:

- Rising Consumption: Rapid population growth, urbanization, and rising consumption patterns increased the demand for imported goods, particularly consumer goods. Higher consumer demand without corresponding growth in exports has contributed to persistent trade imbalances.

- Economic Liberalization: While economic liberalization policies introduced in the late 1970s stimulated growth in sectors like garments and tourism, they also led to a surge in imports due to the removal of trade barriers, further aggravating the trade deficit.

Limited Foreign Direct Investment (FDI):

- Low FDI in Export-Oriented Sectors: Sri Lanka has struggled to attract sufficient FDI into export-oriented industries, which has limited the potential for expanding exports. While FDI has increased in sectors like tourism and infrastructure, it has not significantly enhanced the export capacity of the country.

- Civil War (1983-2009): The decades-long civil conflict severely hampered economic development and international trade. The war disrupted investment, infrastructure development, and exports, particularly affecting industries like tourism and agriculture in the Northern and Eastern regions.

- Political Instability: Frequent changes in government, inconsistent economic policies, and governance issues have also created uncertainties for trade and investment, limiting export growth and exacerbating the trade deficit.

(01 mark each for any four reasons; Total marks 04)

(iii) - Diversification of the Export Base: Sri Lanka's export base is heavily reliant on a narrow range of products, particularly garments, tea, rubber, and coconut. Diversifying into higher- value industries such as electronics, pharmaceuticals, information and communication technology (ICT) services, and agro-processing can promote competitiveness in global markets.

- Promote Value-Added Exports: Instead of exporting raw materials or low-value products, Sri Lanka should focus on moving up the value chain. For example, instead of exporting raw tea, the country could develop branded and specialty tea products, and in the case of rubber, focus on high-tech rubber-based goods like medical devices or automotive parts.

- Industrial Zones and Export Processing Zones (EPZs): Developing more industrial zones with world-class facilities, particularly near ports, can attract foreign investment in export- oriented sectors. Encouraging firms in these zones to produce high-value goods can further boost export growth.

- Improve Productivity and Innovation: The government and private sector should invest in R&D to promote innovation, especially in industries with export potential like agriculture, manufacturing, and services. Supporting research institutions, universities, and firms that focus on product development and process improvements can enhance the global competitiveness of Sri Lankan products.

- Boost Worker Skills and Education: Improving the skills of the labor force through vocational training, technical education, and specialized programs for high-demand sectors (such as ICT, engineering, and high-tech manufacturing) is essential for improving productivity and competitiveness.

- Create a Favorable Investment Climate: Streamlining regulations, reducing bureaucratic hurdles, and ensuring policy stability can help attract more FDI into export-oriented sectors. Sri Lanka should focus on improving its ease of doing business ranking, reducing corruption, and simplifying tax codes to make the country more attractive to investors.

- Develop Strategic Trade Agreements and Market Access:
- Expand Trade Agreements: Sri Lanka should actively pursue bilateral and multilateral trade agreements that provide preferential access to large markets like the European Union, the United States, and emerging economies in Asia.

- Adopt Global Standards: Sri Lankan exporters must ensure that their products meet international quality and safety standards. This includes obtaining certifications such as ISO standards, Fair Trade certification, and organic certification for agricultural products. Adhering to high standards will improve the marketability of Sri Lankan goods globally.

- Digital Transformation: Embracing digital trade and e-commerce platforms can help Sri Lankan exporters, especially SMEs, reach international markets directly. The development of national e-commerce platforms and enhancing digital infrastructure (such as high-speed internet and payment gateways) will be crucial for facilitating cross-border trade.

- Green Energy and Environmental Standards: Encouraging industries to adopt renewable energy sources and reduce their environmental footprint can improve the appeal of Sri Lankan exports, especially in markets that prioritize sustainability.

- Strengthen Anti-Corruption Measures: Reducing corruption and improving transparency in governance can help reduce costs for exporters and attract foreign investment, ultimately boosting the export sector.

(01 mark each for any four factors; Total marks 04)

(iv) - Boost to Exports: A depreciated currency makes a country's goods and services cheaper for foreign buyers. This typically increases demand for exports, potentially improving the trade balance.

- Higher Cost of Imports: Currency depreciation makes imports more expensive in the domestic market since foreign goods are priced in a stronger currency. This leads to reduced demand for imports and can contribute to an improvement in the trade balance if domestic production can substitute imported goods

- Imported Inflation: Higher import costs result in higher prices for imported goods and services, such as fuel, food, and raw materials. This can lead to overall price increases, contributing to cost-push inflation.

  Wage-Price Spiral Risk: As prices rise due to higher import costs, workers may demand higher wages to maintain their purchasing power, which can lead to a wage-price spiral, where rising wages lead to further increases in prices, feeding into more inflation.

- Improved Net Exports: The rise in exports and reduction in imports can increase net exports (exports minus imports), which is a key component of aggregate demand This increase in AD can stimulate economic growth, assuming other factors remain stable. Reduced Consumption and Investment: On the other hand, higher import prices can reduce domestic consumption, as consumers face higher prices for imported goods. Additionally, businesses that rely on imported capital goods or intermediate inputs may face higher costs, which can dampen investment in the economy.

- Increased Foreign Debt Servicing Costs: If a country has a large amount of foreign debt denominated in foreign currencies, currency depreciation increases the cost of repaying that debt in terms of the local currency.

- Attracting Foreign Direct Investment (FDI): A depreciated currency makes the country's assets (land, companies, and investments) cheaper for foreign investors. This could encourage more foreign direct investment (FDI) into the economy, as foreign companies find investment opportunities more affordable.

- Capital Flight and Loss of Investor Confidence: Conversely, currency depreciation can also lead to capital flight, where investors withdraw their funds due to fears of further depreciation, economic instability, or inflation. This is particularly true for portfolio investment, where investors quickly sell stocks, bonds, or other financial assets to avoid losses.

- Potential for Higher Interest Rates: Central banks may raise interest rates in response to currency depreciation to curb inflation and stabilize the currency. However, higher interest rates can also dampen economic growth by increasing borrowing costs for consumers and businesses.

- Widening Income Inequality: Lower-income households, which spend a larger portion of their income on essential goods like food and fuel, may be disproportionately affected by the inflation resulting from currency depreciation.

(01mark each for any six reasons; total marks 06)

09

9. (i) (a) Explain briefly how Gross National Income per capita is used as a measure of development. (02 marks)

(b) What are its limitations as a measure of development? (03 marks)

(ii) Outline the main causes of rapid increase in poverty level of Sri Lanka in the recent years. (04 marks)

(iii) How do poor governance and corruption influence economic development process? (05 marks)

(iv) What challenges does the demographic transition has posed for the labour market and public finances in Sri Lanka? (06 marks)

9. (i) (a)- Indication of Economic Well-Being: GNI per capita is used to measure average income levels within a country, which are often associated with living standards. Higher GNI per capita generally suggests that citizens have access to more resources, higher purchasing power, and better living conditions, while lower GNI per capita indicates limited income and, potentially, lower standards of living.

- Comparisons of Development Between Countries: GNI per capita enables comparisons of economic development between countries. Countries are often categorized into low-income, middle-income, or high-income economies based on their GNI per capita. These classifications are used by organizations like the World Bank to assess the level of economic development and to determine eligibility for development assistance.

- Indication of Economic Growth: GNI per capita is used to track economic growth over time. An increase in GNI per capita can signal improvements in a country's productivity, economic efficiency, and the overall well-being of its citizens.

- Correlation with Other Development Indicators: While GNI per capita is primarily an economic measure, it often correlates with broader development indicators like life expectancy, literacy rates, access to healthcare, and education levels. As a country's

GNI per capita rises, it typically has more resources to invest in social services and infrastructure, leading to improvements in these areas.

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

(b) Its limitations as a measure of development:

- Ignores Income Distribution and Inequality: GNI per capita is an average measure of income, but it does not show how that income is distributed among the population. A country may have a high GNI per capita while a significant portion of its population lives in poverty, as income may be concentrated in the hands of a few.

- Focuses Only on Economic Factors: Non-economic aspects of development are ignored. Development is not just about income; it also includes social, political, and environmental dimensions, such as access to healthcare, education, political freedom, and environmental sustainability. GNI per capita provides no information about these non-economic aspects.

- Social Well-Being Not Captured: Indicators like life expectancy, literacy rates, and quality of life are crucial to understanding development, but they are not reflected in GNI per capita. As a result, two countries with similar GNI per capita can have vastly different levels of social and human development.

- Does Not Reflect Living Standards or Well-Being: GNI per capita does not account for differences in the cost of living across countries. A dollar may have different purchasing power depending on the country. adjustments.

- Quality of Life: GNI per capita does not reflect the quality of infrastructure, public services, housing, or environmental conditions, all of which are crucial to living standards and overall well-being.

Environmental Sustainability and Resource Depletion: Ignores Environmental Degradation: GNI per capita focuses on economic output but does not consider whether the economic activities are sustainable. A country may have high GNI per capita due to the over-exploitation of natural resources, which can lead to long-term environmental degradation, harming future development prospects.

- Volatility of External Income: GNI per capita includes income from abroad (such as remittances and foreign investment). Volatility in these inflows, driven by external factors, can distort the measure of development, as sudden drops in foreign income may not reflect the actual state of the domestic economy.

(01 mark each for any three limitations; 03 marks)

(Total marks 05)

(ii) Main causes of rapid increase in poverty level in Sri Lanka in the recent years:

- Economic Crisis and Stagnation: Sri Lanka has faced a severe debt crisis, with high levels of external borrowing leading to unsustainable debt. This resulted in the country defaulting on its debt in 2022, leading to a lack of access to international credit and a decline in foreign reserves. The debt burden has limited the government's ability to finance social programs, invest in infrastructure, and support vulnerable populations, exacerbating poverty.

- Inflation and Cost of Living: One of the immediate impacts of the economic crisis has been skyrocketing inflation. High inflation, especially in food and energy prices, has eroded household purchasing power, disproportionately affecting low-income groups.

- Currency Depreciation: The sharp depreciation of the Sri Lankan rupee has increased the cost of imports, particularly essential goods like food, fuel, and medicine.

- Corruption: Corruption has exacerbated the crisis, with misallocation of public funds, inefficient public sector management, and reduced foreign investor confidence. Public resources that could have been directed toward poverty alleviation and social welfare were instead diverted, leaving the most vulnerable exposed to the crisis.

- COVID-19 Pandemic: Sri Lanka's economy is heavily dependent on tourism, which contributes significantly to foreign exchange earnings. The COVID-19 pandemic caused a dramatic fall in tourist arrivals, leading to large-scale job losses in the tourism sector and related industries (such as hospitality, transportation, and retail). The loss of income from tourism left many households struggling and increased poverty.

- High Unemployment and Underemployment: The economic crisis and pandemic have caused significant job losses, particularly in sectors like tourism, manufacturing, and construction. This has contributed to declining household incomes and increased poverty.

- Agriculture Sector Challenges: In 2021, the Sri Lankan government imposed a sudden ban on chemical fertilizers in an effort to promote organic farming. This policy, although later reversed, caused severe disruptions in agricultural production, leading to reduced yields in key crops such as rice, tea, and vegetables. The resulting food shortages contributed to price hikes and reduced incomes for farmers, many of whom fell deeper into poverty.

- External Shocks: The global rise in prices for essential commodities such as oil, food, and fertilizer has put further strain on Sri Lanka's economy. As an import-dependent country, Sri Lanka's vulnerability to external price shocks has worsened the domestic inflation situation, directly contributing to poverty.

- Drop in Remittances from Overseas Workers: Remittances from Sri Lankan expatriate workers are a key source of foreign exchange and household income. However, remittance inflows declined sharply during the economic crisis due to exchange rate disparities and reduced global demand for migrant labor. This decline in remittances hit many households, particularly in rural areas, contributing to rising poverty.

- Insufficient Social Welfare Programs: While Sri Lanka has some social welfare programs, they have been insufficient to address the scale of poverty caused by the recent economic crises. The government's ability to expand or effectively implement social protection schemes has been hampered by the fiscal crisis, leaving many poor and vulnerable households without adequate support.

- Impact of Climate Change: Sri Lanka is increasingly vulnerable to climate-related disasters such as floods, droughts, and landslides. These events have disrupted agricultural productivity, displaced communities, and destroyed livelihoods, particularly in rural areas, exacerbating poverty and economic insecurity.

(01 mark each for any four reasons; Total marks 04)

(iii) Poor governance and corruption significantly undermine the economic development process through various channels.

- Resource Misallocation:

  Poor Governance leads to inefficient allocation of resources, where investments may favor politically connected regions or individuals rather than those with the highest need or return.

  Corruption diverts public funds away from productive investments (e.g., infrastructure, healthcare, and education) into personal gain for individuals in power.

- Inhibited Investment:

  Poor Governance creates uncertainty due to inconsistent policies, weak property rights, and a lack of regulatory transparency.

  Corruption increases the cost of doing business through bribes and other informal fees, discouraging both domestic and foreign investment.

- Reduced Efficiency in Public Service Delivery:
  Poor Governance results in delays and bureaucratic inefficiencies, making it harder for citizens and businesses to access necessary services.
  Corruption leads to substandard delivery of public goods and services as contracts and projects are awarded based on favoritism rather than merit.

- Erosion of Public Trust:
  Poor Governance creates perceptions of favoritism, lack of accountability, and unfair treatment.
  Corruption breeds cynicism and distrust in government institutions.
  Deters public cooperation with government policies and undermines social cohesion, which are essential for development initiatives.

- Weak Institutional Frameworks:
  Poor Governance results in weak institutions that cannot effectively manage economic and social challenges.
  Corruption weakens legal and judicial systems, making it harder to enforce contracts and protect property rights.
  Discourages long-term economic planning and sustainable growth.

- Impact on Fiscal Stability:
  Poor Governance leads to budget mismanagement and unsustainable debt accumulation.
  Corruption reduces tax revenues as businesses and individuals evade taxes by bribing officials.
  Limits the government's ability to fund development programs and address macroeconomic imbalances.

- Hampers Innovation and Entrepreneurship:
  Poor Governance reduces the predictability and fairness of the business environment.
  Corruption encourages a rent-seeking culture where businesses focus on gaining political favor rather than improving productivity or innovating. This slows the growth of dynamic sectors and deters entrepreneurial activity.

(01 mark each for five reasons; 05 marks)

(iv) Challenges for the Labor Market:

- Declining Labor Supply: As the birth rate continues to fall and the population ages, the size of the working-age population is shrinking. Fewer young people are entering the labor market, which reduces the overall labor supply. This can lead to labor shortages, particularly in sectors that rely on younger workers, such as technology, manufacturing, and services.

- Dependency Ratio Increase: With a growing elderly population and fewer workers, the dependency ratio (the ratio of non-working dependents to the working-age population) increases. This puts more pressure on a shrinking workforce to support both children and the elderly.

- Aging Workforce:
- Reduced Productivity: As the workforce ages, productivity may decline due to factors such as decreased physical stamina, slower adaptation to technological changes, and higher health-related absenteeism. An older labor force might struggle to meet the demands of rapidly evolving industries, particularly those requiring innovation and high-tech skills.

- Mismatch of Skills: Older workers may not have the skills needed for emerging sectors such as digital technology, artificial intelligence, or green energy. Without significant investment in retraining programs, this skills gap could become a major obstacle to economic growth. **(03 marks)**

- Impact on Public Finances:
- Rising Pension Costs: With a growing elderly population, the demand for pensions and retirement benefits is increasing. Sri Lanka's pension system, which covers public sector employees and some formal sector workers, is already facing financial pressure, and this is expected to worsen as more people retire and live longer. The government will need to allocate a larger share of its budget to meet these rising pension obligations.

- Healthcare Expenditures: An aging population will require more healthcare services, particularly for chronic conditions like heart disease, diabetes, and dementia. Public health systems will face increased strain, as elderly individuals typically require more frequent and costly medical care. This rising demand for healthcare services will put pressure on public finances,.

- Reduced Tax Revenue:A shrinking working-age population means fewer taxpayers, which reduces the government's ability to generate revenue.

- Increased Fiscal Deficits: The combination of rising public spending (on pensions and healthcare) and shrinking tax revenues will create larger fiscal deficits. Sri Lanka already faces a significant public debt burden, and these demographic pressures will further complicate efforts to stabilize public finances and reduce debt.

- Pressure on Public Infrastructure and Services:
- Elderly Care Services: As the population ages, there will be greater demand for public infrastructure and services tailored to the elderly, such as assisted living facilities, nursing homes, and specialized transportation services. Expanding these services will require significant investment in both human and financial resources.

(03 marks)

(Total marks 06)

10

10. (i) State briefly the key factors that have contributed to the economic crisis Sri Lanka is experiencing at present. (04 marks)

(ii) What role are the international financial institutions playing in supporting Sri Lanka during the current economic crisis? (04 marks)

(iii) What key challenges must be addressed to achieve economic recovery and sustainable growth in Sri Lanka over the next five-year period? (06 marks)

(iv) How can the improvement of digital infrastructure promote economic growth, economic efficiency and global competitiveness of Sri Lanka? (06 marks)

10. (i) The key factors that have contributed to the economic crisis Sri Lanka :

- Sri Lanka's economic crisis is the result of a combination of internal mismanagement and external shocks. The key factors contributing to the crisis include:

- Unmanageable external debt: The country accumulated unsustainable levels of external debt, mainly through heavy borrowing for infrastructure projects, which did not yield sufficient economic returns. This increased debt servicing costs, leading to balance-of- payments problems. In 2022, Sri Lanka defaulted on its debt for the first time in history, eroding investor confidence. A significant portion of government revenue was diverted toward servicing debt, leaving little for essential expenditures.

- Foreign Exchange Shortages: A decline in foreign reserves, caused by reduced tourism and remittances (due to the COVID-19 pandemic), combined with the need to service large foreign debts, led to acute shortages of foreign currency. This hampered the country's ability to import essential goods like fuel, food, and medicine.

- COVID-19 Pandemic: The pandemic severely disrupted key sectors like tourism and exports, both of which are vital sources of foreign exchange for Sri Lanka. The economic downturn also increased unemployment and poverty levels.

- Policy Missteps: Poor economic management, such as the abrupt shift to organic farming by banning chemical fertilizers, led to a sharp decline in agricultural productivity. Tax cuts introduced in 2019 reduced government revenue, exacerbating the fiscal deficit. Exchange rate mismanagement: Artificially maintaining an overvalued currency resulted in an unsustainable foreign exchange regime, worsening the foreign reserves crisis.

- Rising Inflation: High inflation, driven by the currency depreciation and supply shortages, has eroded purchasing power and worsened living conditions, leading to widespread protests. Printing of money by the Central Bank to finance deficits led to skyrocketing inflation.

- Impact of global events: COVID-19 pandemic: The pandemic devastated the tourism industry, a significant foreign exchange earner, and reduced remittance inflows from expatriates. Ukraine-Russia conflict: The war exacerbated global energy and food prices, increasing Sri Lanka's import bills for essential commodities like fuel and wheat.

- Governance and corruption: Frequent changes in leadership and lack of coherent economic policy undermined confidence. Mismanagement of funds, lack of transparency, and questionable infrastructure investments exacerbated economic vulnerabilities. Weak institutions: Poor governance in public finance and policy implementation weakened the country's ability to respond to the crisis effectively.

(01 mark each for any four reasons; Total marks 04)

(ii)
- International financial institutions (IFIs) have been instrumental in supporting Sri Lanka's recovery from its recent economic crisis through financial assistance, policy guidance, and debt restructuring efforts.

- The International Monetary Fund (IMF) provided Sri Lanka with a crucial bailout package to help stabilize its economy. In March 2023, the IMF approved a $3 billion Extended Fund Facility (EFF) arrangement for Sri Lanka to restore macroeconomic stability and debt sustainability. The program aims to mitigate the economic impact on the poor and vulnerable, safeguard financial stability, and strengthen governance.

- The IMF has facilitated discussions on debt restructuring, urging creditor nations and private bondholders to engage in negotiations. This process aims to ensure that Sri Lanka can meet debt obligations while also freeing up resources for essential services and development.

- During Sri Lanka's recent economic crisis, the World Bank provided substantial assistance through financial support and policy reforms aimed at stabilizing the economy and protecting vulnerable populations.

- In June and December 2023, the World Bank disbursed a total of $500 million under the first Resilience, Stability, and Economic Turnaround (RESET) programme to support foundational reforms for macroeconomic stability and social protection.

- This was followed by the Second RESET in October 2024, which provided an additional $200 million to further economic governance and competitiveness reforms.

- In 2022, the World Bank repurposed funds from existing projects to address urgent needs, including cash transfers, procurement of liquid petroleum gas, and provision of fertilizers.

- In 2023, the IFC committed up to $400 million to assist Sri Lankan banks in facilitating imports of essential goods, including food, medicine, and fertilizers. This financing aimed to ensure the continued availability of critical supplies during the crisis.

- During Sri Lanka's economic crisis, the Asian Development Bank (ADB) provided significant assistance through financial support and policy reforms aimed at stabilizing the economy and strengthening the financial sector.

- In May 2023, ADB approved a $350 million loan to support Sri Lanka's economic stabilization efforts. This loan was part of a broader financial assistance package anchored by the International Monetary Fund's Extended Fund Facility, aiming to stabilize the economy and lay the foundation for recovery and sustained growth.

- In December 2023, ADB approved a $200 million concessional loan to help stabilize Sri Lanka's finance sector following the sovereign debt and economic crises. This program aimed to strengthen the stability and governance of the banking sector, improve asset quality, and enhance access to finance, particularly for women-led micro, small, and medium-sized enterprises.

- IFIs have offered technical support in areas such as public financial management, fiscal policy reforms, and economic governance. This assistance is intended to improve the country's institutional capacity to manage the crisis and implement necessary reforms.

(01 mark each for any four involvements; Total marks 04)

(iii) - Achieving economic recovery and sustainable growth in Sri Lanka over the next five years will require addressing several key challenges:

- Debt Restructuring and Management: Efficiently restructuring the country's unsustainable debt is critical. This involves negotiating with creditors to achieve a manageable debt burden while ensuring that future borrowing is sustainable and transparent.

- Restoring Macroeconomic Stability: Maintaining macroeconomic stability, including controlling inflation and stabilizing the currency, is essential. This may require sound monetary policy, fiscal discipline, and a commitment to maintaining foreign reserves.

- Economic Diversification: Reducing dependence on a few key sectors, such as tourism and tea exports, by promoting diversification into other sectors (e.g., technology, manufacturing, and agriculture) will help build a more resilient economy.

- Enhancing Governance and Institutional Capacity: Strengthening governance, reducing corruption, and enhancing institutional capacity are crucial for effective policy implementation and economic management. Transparent and accountable governance can improve investor confidence and public trust.

- Investment in Human Capital: Focusing on education and skills development will be vital to enhance the workforce's productivity and adaptability. Improving health services and education infrastructure will contribute to long-term economic growth.

- Infrastructure Development: Investing in critical infrastructure, such as transportation, energy, and digital connectivity, can facilitate economic activity, attract foreign direct investment, and enhance the overall business environment.

- Promoting Private Sector Growth: Creating a conducive environment for private sector investment and entrepreneurship, including regulatory reforms and access to finance, will be essential for economic recovery and job creation.

- Addressing Social Inequalities: Implementing policies to reduce poverty and inequality is crucial for sustainable development. Social safety nets and targeted assistance programs can help vulnerable populations affected by the crisis.

- Environmental Sustainability: Integrating sustainable practices into economic planning and development is essential to address environmental concerns. Emphasizing green energy, sustainable agriculture, and conservation efforts will support long-term growth and resilience.

- Fostering Regional and Global Trade Relationships: Strengthening trade relationships and exploring new markets can help Sri Lanka diversify its export base and enhance economic resilience. Trade agreements and partnerships can facilitate access to new markets.

(01 mark each for any six challenges; 06 marks)

(iv) - The level of digital infrastructure plays a crucial role in shaping the overall economic growth and competitiveness of Sri Lanka

- Enhancing Connectivity and Accessibility: Robust digital infrastructure improves connectivity across urban and rural areas, enabling businesses and individuals to access information, services, and markets.

- Boosting Productivity: Digital tools and technologies can streamline operations, enhance efficiency, and reduce costs for businesses. Improved productivity in various sectors, including manufacturing, services, and agriculture, can lead to higher economic output and competitiveness.

- Facilitating E-Commerce and Trade: A strong digital infrastructure supports the growth of e-commerce, enabling businesses to reach broader markets, both domestically and internationally.

- Attracting Foreign Investment: Countries with advanced digital infrastructure are often more attractive to foreign investors. Improved digital capabilities can enhance the ease of doing business, providing a competitive edge that draws investment in technology-driven sectors.

- Fostering Innovation and Entrepreneurship: A well-developed digital ecosystem supports innovation and entrepreneurship by providing access to digital tools, resources, and networks.

- Improving Public Services and Governance: Digital infrastructure can enhance the delivery of public services, making them more efficient and accessible. E-governance initiatives can improve transparency, reduce corruption, and enhance citizen engagement, leading to better governance and economic stability.

- Expanding Educational Opportunities: Improved digital infrastructure can facilitate access to education and training programs, enhancing the skill sets of the workforce.

- Supporting Digital Finance: Access to digital financial services can enhance financial inclusion, allowing individuals and businesses to access credit, savings, and insurance. This can empower small and medium-sized enterprises (SMEs) and promote economic resilience.

- Enhancing Data-Driven Decision Making: Digital infrastructure enables the collection and analysis of data, allowing businesses and policymakers to make informed decisions.

(01 mark each for any six reasons; total marks 06))

NOTES