

**THE OPEN UNIVERSITY OF SRI LANKA  
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/PUBLIC  
ADMINISTRATION PROGRAMME  
FINAL EXAMINATION – 2019 SEPTEMBER  
MSP9405/ MSP 1605 – ECONOMIC ENVIRONMENT OF BUSINESS  
DURATION: THREE (03) HOURS**



**DATE: 01.09.2019**

**TIME: 9.30 AM – 12.30 PM**

**Answer any four (04) questions. All questions carry equal marks (25 marks)**

**Question No.01**

- a) "Government intervention is necessary to achieve economic efficiency when externalities exist" Providing an example each for positive and negative externality, explain whether you "agree" or "disagree" with the above statement. Use illustrations to explain your answer. (Marks 06)
- b) While distinguishing public goods from private goods, explain why private firms cannot be normally expected to produce public goods. (Marks 05)
- c) "The government pays attention to elasticity of demand when selecting goods and services on which to levy taxes" Do you agree? Provide examples and illustrations to explain your answer. (Marks 06)
- d) "The price elasticity of supply varies directly with the amount of time producers have to respond to price changes". Taking tomatoes as an example explain how price elasticity of supply changes in the immediate market period after the price change, in the short and also in the long run. How would the change in demand for tomatoes affect the given market in these periods? Provide examples to explain your answer. (Marks 08)

**Question No. 02**

- a) "Even if a perfectly competitive firm losing money it is better to stay in business in the short run" Using illustrations explain the relevance of the said statement. (Marks 05)
- b) Using illustrations explain how entry and exit of firms in a perfectly competitive industry cease when the firms in the industry return to making normal profit." (Marks 08)
- c) "As the monopolist can control product price, firm is always assured of profitable production by simply charging price, the consumer will pay" Do you agree? Explain. (Marks 05)
- d) "With respect to resource allocation the interest of the seller and of society coincide in a perfectly competitive market, but conflict in a monopolized market" Comparing price and output decisions of both these markets, explain whether you "agree" with the said statement. (Marks 07)

**Question No. 03**

- a) Non price competitive methods used by monopolistic competitive and oligopolistic firms aim at making price less of a factor in consumer purchases". While highlighting different aspects of product differentiation and positive & negative effects of advertising discuss the relevance of the said statement in modern day business environment. **(Marks 10)**
- b) Would it be possible for firms operating in monopolistically competitive industry to achieve productive and allocative efficiency in the long run? Explain using illustrations. **(Marks 06)**
- c) How would the following models describe pricing and output decisions of firms that operate in oligopoly markets?
- i. Kinked Demand curve model.
  - ii. Collusive Pricing (Cartel) model. **(Marks 09)**

**Question No. 04**

- a) Why levels of savings and investments of a country are vital to enhance living standards of its people? Explain. **(Marks 05)**
- b) "In contrast to consumption, investment is unstable, it is the most volatile component of total spending" Do you agree? Explain taking current economic and political environment of Sri Lanka into consideration. **(Marks 06)**
- c) Providing relevant illustrations explain the impact of following changes on the equilibrium rate of interest in the market.
- i. Economy experiences high rate of inflation.
  - ii. Economy grows and level of income of people increases.
  - iii. Central bank sells government bonds and securities in the open market.
  - iv. Central bank reduces the reserve requirement of commercial banks. **(Marks 08)**
- d) "Investors may not respond positively to lower rate of interest under economic recession and also may not respond negatively to higher rate of interest during economic boom." Do you agree? Explain. **(Marks 06)**

**Question No. 05**

- a) i. Many governments run budget deficits year after year and chronic budget deficits could pose several economic challenges to governments. What are these challenges? Explain. **(Marks 05)**
- ii. Will the higher budget deficits at present reduce the growth rate of economy in the future? Do the reasons for higher budget deficit matter? Explain. **(Marks 06)**
- b)i. What are the economic indicators of business cycles? Explain. **(Marks 04)**
- ii. "Although fiscal policy is a viable backup tool for aiding monetary policy in overcoming recession and controlling inflation, the government may encounter problems in enacting fiscal policy." Discuss, providing examples. **(Marks 10)**

**Question No. 06**

- a) "Countries benefit from trade across the borders, yet there is tendency for countries to erect trade barriers"
- i. Providing examples highlight the benefits of international trade. (Marks 04)
  - ii. What are the arguments protectionists make in justifying trade barriers. (Marks 04)
  - iii. Using illustrations analyze the economic effects of tariffs and quotas. (Marks 05)
  - iv. what are the invisible trade barriers? Explain. (Marks 04)
- b) Current account deficit can be tackled by devaluing the domestic currency or allowing it to depreciate. How effective is the said policy in reducing current account deficit? What are the problems associated with such policy measure. (Marks 08)

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