

**THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/PUBLIC
ADMINISTRATION PROGRAMME
FINAL EXAMINATION – 2021 APRIL
MSP9405/ MSP 1605 – ECONOMIC ENVIORNMENT OF BUSINESS
DURATION: THREE (03) HOURS**



DATE: 03.04.2021

TIME: 9.30 AM – 12.30 PM

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

Question No.01

- a) "Imposition of legal prices by the government impedes the rationing function of prices, distorts resource allocation and causes negative side effects." Using illustrations and examples, explain whether you agree with the given statement. **(06 Marks)**

- b) "Some costs and benefits are external to the market mechanism, and are thus neglected, causing distortion in resource allocation" Elaborate the given statement by citing an example each for a positive and negative externality.
Based on the examples provided above, explain what steps the government could take to improve the resource allocation in each situation. Use illustrations to explain your answer. **(07 Marks)**

- c) i) Explain how the revenue of a firm changes in response to price and income changes if the price and income elasticity of demand for its product are "- 1.72" and "2.08" respectively. (Provide illustrations where appropriate) **(06 Marks)**

- ii) If the intention of policy makers is to increase tax revenue, which is more effective, imposing taxes on goods with "Elastic" demand or "Inelastic" demand? Use appropriate examples and illustrations to explain your answer. **(06 Marks)**

Question No. 02

- a) i. "No industry operating in the real world precisely confirms to the market model Perfect Competition, therefore, the given model has no practical importance" Discuss. **(06 Marks)**

- ii. "Perfectly Competition is a form of market structure that produces productive and allocative efficiency in the long run" Using illustrations explain whether you agree with the given statement. **(07 Marks)**

- b) How would a Monopolist make pricing and output decisions when it aims at,
 - i. maximizing profit.
 - ii. maximizing revenue? Explain your answer using illustrations. **(06 Marks)**

- c) Would the society gain or lose, when all the firms in a Perfectly Competitive industry merge and the industry becomes a Monopoly? Explain using an appropriate illustration. **(06 Marks)**

Question No. 03

- a) "Firms that operate in a Monopolistically Competitive market only make normal profit in the long run and they fail to achieve economic efficiency" Do you agree? Explain with illustrations. Despite what the theory explains, could the employment of non-price competitive methods help the real-world firms to enhance their profitability in the long run. **(10 Marks)**
- b) "Economies of Scale are an important entry barrier in some Oligopoly industries and in addition Oligopoly firms could use retaliatory pricing and advertizing to prevent new firms from entering their markets" Elaborate with examples. **(07 Marks)**
- c) Uncertainties in Oligopoly markets encourage collusive behavior among the firms in an Oligopoly Industry. Using an illustration explain how the collusive behavior helps these firms to enhance their Joint Profit. What are the obstacles that prevent firms from colluding? Explain **(Marks 08)**

Question No. 04

- a) i. What factors make the Aggregated Demand curve (AD) negatively sloping? Explain. Compare and contrast the "Classical" and "Keynesian" views in relation to the shape of Aggregate Supply curve (AS). **(Marks 06)**
- b) Using AD/AS framework explain how the following changes affect the average price level and the real output in an economy. Use illustrations to explain your answer.
- There has been a sharp decline in the price of oil in the world market.
 - Sharp increase in the cost of imported inputs necessary for local production.
 - The Covid conditions restricted the movements of the workers and also reduced the real income of people.
 - To mitigate the negative impact of Covid pandemic, the government reduced taxes. **(12 Marks)**
- c) Explain the impact of persistently higher inflation on an economy of a country. **(07 Marks)**

Question No. 05

- a) How is the exchange rate between two currencies determined under fixed exchange rate mechanism? What are the advantages and disadvantages in the said mechanism? Use illustrations to explain your answer. **(06 Marks)**
- b) Using illustrations explain how the under mentioned changes affect the exchange rate between Sri Lankan Rupee and Japanese Yen.
- The rate of interest in Japan has risen and it is higher than the domestic rate.
 - There has been a sharp increase in the domestic rate of inflation and it is higher than Japan.
 - There has been a rise in the Japanese demand for Sri Lankan exports.
 - The Sri Lankan authorities has imposed restrictions on the importation of motor vehicles and this has severely reduced the importation of motor vehicles from Japan. **(12 Marks)**

- c) How could the depreciation/devaluation of the domestic currency help in reducing the deficit in the current account in Balance of Payments? What are the problems associated with a such a move? Explain. **(07 Marks)**

Question No. 06

- a) "Free trade promotes economic growth by allowing countries to specialize." Providing examples and taking the current economic environment created by the Covid pandemic into consideration, discuss the validity of the given statement. How relevant are the arguments put forward in justifying the trade barriers, under the current world economic environment? Explain. **(10 Marks)**
- i. What determines the economic growth of a country?
 - ii. Identify the public policies that could effectively enhance the economic growth of a country.
 - iii. What are the costs of economic growth? Explain **(09 Marks)**
- b) Could the rate of interest be effectively used in controlling economic recessions and booms? How will the investors respond to changes in rate of interest under recessionary and booming economic conditions? Explain. **(06 Marks)**

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