THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/PUBLIC ADMINISTRATION PROGRAMME
FINAL EXAMINATION – 2022 MARCH
AFP9405/ MSP9405/ MCP1605 – ECONOMIC ENVIORNMENT OF BUSINESS
DURATION: THREE (03) HOURS

DATE: 26.03.2022	TIME: 9.30 AM – 12.30 PM

Answer any five (05) questions. All questions carry equal marks (20 marks)

Question No. 01

A) a) Explain how the free-market mechanism may fail to allocate resources efficiently when;
i. Firm pollutes the environment in the process of production.
ii. Carrying out a vaccination programme against Covid 19 pandemic.

b) Would the above situations cause over or under allocation of resources? How could the government intervene in improving the market efficiency? Explain using illustrations. **(07 Marks)**

B) Using the knowledge in the "Concept of Elasticity" answer the following, where possible use illustrations to explain your answer.
i. Why may the larger crop yields reduce the farmer revenue?
ii. Why some economists argue that legalization of hard drugs like heroin is the best solution to control drug related problems? **(08 Marks)**

C) "Coefficients of income elasticity of demand provide insights into the economy". Taking the conditions created by the Covid pandemic into consideration, explain the relevance of the given statement. **(05 Marks)**

Question No. 02

A) i. Using illustrations describe how profits and losses in the short run drive the long run adjustment process of Pure Competition. **(07 Marks)**
ii. How would the long run equilibrium in Pure Competition produce economic efficiency? Explain. **(04 Marks)**

B) i. Where would the profit maximizing Monopolist choose its price quantity combination, in the elastic or inelastic region of its demand curve? Explain using illustrations. **(04 Marks)**

ii. Compare and contrast the economic effects of Monopoly and Pure Competition. **(05 Marks)**

Question No. 03

A) "The product variety and improvements achieved under Monopolistic Competition may greatly reduce the efficiency loss associated with its long run equilibrium" Do you agree? Explain. **(08 Marks)**

B) "In non-Collusive Oligopolistic industries prices are generally stable." Using an appropriate market model explain whether you agree with the above statement. **(06 Marks)**

C) In order to maximize profit, firms in Oligopoly markets tend to collude. What are the obstacles for such collusive behavior? Explain. **(06 Marks)**

Question No. 04

A) i. Why is it not possible for a country to have lower nominal rate of interest, when it is experiencing very high rate of inflation? **(04 Marks)**

ii. Interest rates are the critical prices that determine the level of productive investment, yet why the investors may not respond positively to lower rate of interest, under recessionary conditions?
Suppose the economy is booming, would the investors respond negatively to higher rate of interest? Explain taking conditions created by Covid pandemic as an example. **(07 Marks)**

B) a) Why is the Demand for money curve has a negative slope? Explain. **(03 Marks)**

b) Providing relevant illustrations explain the impact of following changes on the equilibrium rate of interest in the market.
i. Through open market operations Central Bank sells government bonds and securities to the public.
ii. Extremely higher rate of inflation prevails in the country.
iii. Economy contracts and there has been a decline in people's income.
(06 Marks)

Question No. 05

A) What factors make the Aggregate Demand (AD) curve negatively slopped? Explain. **(03 Marks)**

B) When the budget deficit is higher, the governments tend to increase both direct and indirect taxes to enhance its revenue.

i. Using Aggregate Demand and Aggregate Supply framework critically analyze demand and supply side impact of higher taxation. **(06 Marks)**

ii. How would the higher budget deficit at present affect the future economic growth of a country?
Do the revenue for higher budget deficit, for example, lower taxes, higher public spending on education/health etc. matter? Explain. **(06 Marks)**

C) 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.
i. There has been a sharp increase in the price of imported inputs necessary for local production.
ii. There has been a sharp increase in the amount of imports. **(05Marks)**

Question No. 06

A) i. What are the underlying reasons that bring benefit to the countries when engaged in international trade, in other words, what is the economic basis of international trade? **(04 Marks)**

B) In spite of the benefits of trade, countries tend to erect both visible and invisible barriers to free trade.

i. What is meant by invisible trade barriers? Explain with examples. **(04 Marks)**

ii. Using illustrations analyze the economic impact of "Tariffs" and "Quotas". **(06 Marks)**

C) Critically analyze the relevance of most frequently cited arguments in favour of protectionism. **(06 Marks)**

Question No. 07

A) It is necessary for the exchange rate system of a country to be robust. Which system is more robust, Is it the "Fixed" or the "Flexible" exchange rate system? Explain. **(03 Marks)**

B) Under floating exchange rate mechanism, how would the Sri Lankan rupee behave against U.S.A. dollar, when;
i. The rate of interest in Sri Lanka is higher than that of U.S.A.
ii. The rate of inflation in Sri Lanka is higher than that of U.S.A.
iii. The government of Sri Lanka imposes strict restrictions on imports from other countries. **(09 Marks)**

C) One method of tackling the higher trade deficit is to allow the domestic currency to depreciate. How effective is the said policy in reducing the deficit? What are the problems associated with such policy measure? Explain taking the economy of Sri Lanka as an example. **(08 Marks)**