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THE OPEN UNIVERSITY OF SRI LANKA

**COMMONWEALTH EXECUTIVE MASTER OF BUSINESS ADMINISTRATION/PUBLIC
ADMINISTRATION PROGRAMME**

FINAL EXAMINATION – 2012

MCP 1605 – ECONOMIC ENVIRONMENT OF BUSINESS

DURATION: THREE (3) HOURS

DATE : 17.03.2012

TIME: 9.30pm – 12.30pm

Answer Part “A” and any two (02) questions from Part “B”

Part “A”

- (1) (a) Recently, the Sri Lankan Rupee fell sharply in value against most of the major currencies. For each of the following, say whether you “agree” or “disagree”. Explain your answer.
- i) This is likely to create upward pressure on the Domestic Rate of Interest.
 - ii) With the depreciation of the Domestic Currency, the balance of trade is likely to worsen initially and with the time it may improve.
- (25 marks)
- (b) “The Central Bank of Sri Lanka recently shifted away from managed exchange rate policy and has adopted a more flexible exchange rate policy”
- i) What do you understand by the above statement ? Explain.
 - ii) Suppose under a Flexible Exchange Rate policy, the government consider a policy of cutting taxes. What is the impact of such a policy on the Economy ? Explain.
- (15 marks)

Part 'B'

- (2) (a) Providing examples explain how the business managers can use their knowledge in Concept of Elasticity (Price/Income/Cross price/Advertizing) in making effective decisions.
(15 marks)
- (b) i) Provide practical reasons that bring about Economies and Diseconomies of scale in production, as a firm expands.
ii) How would this determine the shape of the long run Average Cost Curve ? How useful is this in Business decision making ? Explain.
(15 marks)
- (3) (a) "Relative to a Perfectly Competitive industry, a Monopolist restricts output, charges a higher price, as a result of that wealth moves from the consumer to the seller" Do you agree ? Explain.
(10 marks)
- (b) Using illustrations, explain whether you "agree" or "disagree" with the following statements.
i) When firms operating in a Perfectly Competitive industry make abnormal profit in the short run, the supply in the industry will drop in the long run.
ii) For Monopolist, an increase in output involves not just producing more and selling it, but reducing the price of its output to sell it.
iii) If a group of profit maximizing Oligopolists colludes on price and output, the result is exactly the same as it would be if a Monopolist controlled the entire industry.
(20 marks)
- (4) (a) Suppose that shoe manufacturers are making positive profits in the short run. Using illustrations explain how the shoe industry behaves in the long run.
(10 marks)
- (b) "The advocates of spirited competition believe that differentiated products and advertizing give the market system its vitality and are the basis of its power. They are the only ways to satisfy the enormous range of tastes and preferences in a modern economy" Discuss with examples.
(20 marks)

- (5) (a) Suppose there are two goods rice (X) and clothing (Y) produced by two countries Home (H) and Foreign (F). The table given below indicates the amount of labour hours required to produce one unit of each product.
Labour hours needed to produce a unit of X and Y.

Country	X	Y
Home (H)	24	12
Foreign (F)	06	09

Explain how the pattern of trade between the two countries, is determined according to ;

- i) Absolute Advantage theory.
- ii) Comparative advantage theory. (10 marks)

- (b) “One of the great economic debates of all time revolves around the free trade – versus – protection controversy. However trade barriers prevent a nation from reaping the benefits of Specialization, push it to adopt relatively inefficient production techniques and force consumers to pay higher prices for protected products than they would otherwise pay”.

- i) What is meant by Specialization ?
- ii) What are the barriers against free trade ? Explain with examples.
- iii) Under what circumstances can you defend trade protectionism ? Explain with examples. (20 marks)

- (6) “Some economists argue that the government should avoid active use of Fiscal and Monetary policy in trying to stabilize the Economy. They claim that these policy instruments should be set to achieve long-run goals such as rapid economic growth and low inflation and that the economy should be left to deal with short run fluctuations on its own”

- i) Using illustrations explain how the Central Bank can use open market operations to influence the money supply, thus the rate of interest in an economy.
- ii) Taking Sri Lankan Economy as an example explain how the government manipulate fiscal and monetary policy in achieving economic growth and lower inflation in the recent past.
- iii) Providing examples discuss the impact of higher domestic inflation on the Business Organizations. (30 marks)