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THE OPEN UNIVERSITY OF SRI LANKA
THE COMMONWEALTH EXECUTIVE MASTERS OF BUSINESS/PUBLIC ADMINISTRATION
FINAL EXAMINATION – 2015
ECONOMIC ENVIRONMENT OF BUSINESS – MCP 1605
DURATION – THREE (03) HOURS

DATE : 15.08.2015

TIME : 01.30 P.M. - 04.30 P.M.

Answer Part – A (40 Marks) and any three (03) questions from Part B (20 marks each)

PART - A

SRI LANKA'S ECONOMIC OVERVIEW – WORLD BANK

Sri Lanka is focusing on long-term strategic and structural development challenges as it strives to transition to an upper middle-income country. Key challenges include boosting investment, including in human capital, realigning public spending and policy with the needs of a middle-income country, enhancing the role of the private sector, including the provision of an appropriate environment for increasing productivity and exports, and ensuring that growth is inclusive.

Economic growth in Sri Lanka has been among the fastest in South Asia in recent years. Growth averaged 6.3 percent between 2002 and 2013, with Gross Domestic Product (GDP) per capita rising from US\$859 in 2000 to US\$3,256 in 2013. Preliminary indications are that GDP further increased by 7.8 percent in 2014.[1]

For most of the past decade, growth has been pro-poor, with consumption per capita of the bottom 40 percent growing at 3.3 percent a year, compared to 2.8 percent for the total population. Other human development indicators are also impressive by regional and lower middle income standards. Sri Lanka has surpassed most of the Millennium Development Goal (MDG) targets set for 2015, outperforming nearby country comparators on most MDGs.

Notwithstanding declining poverty, 13 districts comprising 36 percent of the total population remain below the national poverty headcount. In four conflict-affected border districts, poverty rates are at or above 20 percent. While the national unemployment level is low at 4.4 percent, 14 districts report unemployment rates higher than the national average. According to Department of Census and Statistics survey data of 2011, 76 percent of total unemployed are below 29 years of age.

Growth during the past five years has been in form of a peace dividend resulting from reconstruction efforts and increased consumption. Sustaining broad-based economic growth into the future will require determined structural reforms that stimulate productivity growth

and economic diversification across sectors, driven by technology and innovation, and new market development domestically and internationally. As part of Sri Lanka's structural economic transformation, employment in primary agriculture will likely continue to decline from its present share of 30 percent of the labor force as other sectors of higher productivity absorb rural surplus labor. At the same, along with productivity increases, agriculture is likely to become more capital intensive and technology-driven as labor shortages emerge.

Improving the quality of human capital through effective education and skills development is central to Sri Lanka's economic growth and competitiveness. Continued growth will also depend largely on fostering private sector development and private investment, especially increased foreign direct investment (FDI). Sri Lanka's economy depends on FDI to bring in innovation. The import of FDI is further underscored by the country's limited domestic savings rate, brought about largely by its demographic trends. Contrary to most economies in South Asia, Sri Lanka does not have a demographic dividend: by 2036, more than 22 percent of the population will be over 60, and there will be 61 dependents per 100 adults. Increases in the labor force, employment rates and productivity will be central to growth. Against the background of an aging society, efficient and well-targeted social assistance will also become more important.

Against this backdrop, Sri Lanka is in the midst of fundamental political change, following the election of Maithripala Sirisena as President of the country in January 2015. President Sirisena and his Government have committed to a rapid 100 day program focused largely on restructuring government after which Parliament is to be dissolved and general elections held. The winning coalition in these elections would be expected to form a long-term government with a corresponding economic policy direction.

[1] Central Bank of Sri Lanka, 2015

Last Updated: Jun 23, 2015

Growth Performance and Prospects

Sri Lanka's growth and competitiveness are constrained by a skills gap that has emerged with the changing labor market conditions. The World Bank is helping to identify and address the particular challenges to skills development in Sri Lanka. Beyond assisting the country's education systems, World Bank supported analytical work has helped Sri Lanka's education authorities in identifying critical policy issues related to the demand and supply of skills in a changing labor market environment, with a view to making the workforce development system more responsive to the labor market. The work informed a Skills Development Project, approved in May 2014, which aims to expand the supply of skilled and employable workers by increasing access to quality and labor market-relevant training programs. Several innovative reforms are being supported under the project. The IDA credit of \$101.4 million for the project will be complemented by a \$100 million loan from the Asian Development

Bank (through parallel financing) which is financing the implementation of the government's Skills Sector Development Program for 2014-2020

Fiscal Sector

The World Bank has been helping the government assess the composition of its public expenditures as it looks to align its spending with the needs of a middle-income country and improve the efficiency by which it uses public resources for service delivery, particularly in the education and health sectors. A Public Expenditure Review completed in June 2014 provides an analytical basis for the government to use public resources more effectively and in ways that promote economic growth and reduce poverty. World Bank analytic and advisory activities have also been outlining alternative financing arrangements for public infrastructure and services (including public-private partnerships) and the pros and cons of the various options. The experiences of other middle-income countries have informed this exercise.

Adapted from- <http://www.worldbank.org/en/country/srilanka/overview>

Question No 1.

- a) How conducive is the current policies of the government in boosting investments and enhancing the role of the private sector? Explain with examples. **(06 Marks)**
- b) How effective have been the policies of the successive governments in attracting Foreign Direct Investments (FDI) into the country? What factors have hindered in attracting satisfactory levels of FDI? Explain. **(07 Marks)**
- c) What is meant by "ensuring that growth is inclusive"? Explain. **(03 Marks)**
- d) Some governments run higher budget deficits and economists generally agree that higher budget deficits today will reduce the growth rate of the economy in the future. Why? Do the reasons for higher budget deficit matter, for example, whether it is due to high government spending on infrastructure, expansion of public sector employment, tax cuts etc.? Explain. **(08 Marks)**
- e) "Sustaining broad-based economic growth into the future will require determined structural reforms that stimulate productivity growth and economic diversification across sectors, driven by technology and innovation, and new market development domestically and internationally". Elaborate. **(10 Marks)**
- f) The importance of expansion and diversification of the export base of a country cannot be underestimated. How effective has been the recent depreciation of the Sri Lankan rupee in enhancing the domestic export sector performance? explain **(06 Marks)**

Total = (40 Marks)

PART -B

Question No. 02

- (a) i “Interference with the functioning of free and competitive markets is likely to result in resource allocation problems and reduced efficiency”. Using illustration explain whether you agree with the above statement taking Agricultural price support measure introduced by the government as an example.
- ii. Due to high demand for rented accommodation in a city, the city council has imposed a maximum legal rent on housing. Using illustrations explain the short and the long run impact of this on the rental housing market. **(08 marks)**
- (b) A country in order to control hard drugs contemplates on the following three steps.
- i. Serious crack down on drug trafficking by the law enforcement authorities.
 - ii. Carrying out an effective campaign to educate people on the negative impact of using drugs.
 - iii. Legalization of the usage of drugs.
- Using illustrations Explain the impact of the above steps on the market for hard drugs. **(09 marks)**
- (c) Using the knowledge on Concept of Elasticity, explain why a conducive weather conditions can reduce farmer revenue ? **(03 marks)**

Question No. 03

- (a) i. “It is not possible to find any industry that exactly confirms the market model of Perfect Competition, in the real world. Therefore the model Perfect Competition has no practical value at all”. Do you agree ? Explain **(06 marks)**
- (b) What is a “Natural Monopoly” ? Do Natural Monopolies still exist? Explain using illustration. **(05 marks)**
- (c) Do you “agree” or “disagree” with in following statements ? Explain using illustrations.
- i. “Monopolies tend to earn abnormal profit by choosing a price higher than would be the case, if the industry were competitive”.
 - ii. When the price elasticity of demand is “-1” then the marginal revenue of the monopolist is” “0” and the total revenue is maximum. **(09 marks)**

Question No. 04

- (a) i. When looking at the allocative efficiency, what market structure is used as the benchmark? Why? Explain using illustrations. **(05 marks)**
- (b) i. "Insurance industry is made up of about four very large firms and many smaller firms. Because there are many firms, the insurance industry should be classified as Monopolistically Competitive". Do you agree? Explain.
- ii. Using illustrations explain whether firms operating in Monopolistically Competitive Industry achieve allocative efficiency in the;
- i. Short run
 - ii. Long run **(06 marks)**
- (c) "The disastrous effect of price wars on the Profits of firms in Oligopolistic markets Provide an incentive for sellers to collude. Collusion enables individual producers to share monopoly profits with other producers" Using illustrations, elaborate.

(09 marks)**Question No. 05**

- (a) i. What factors make the Aggregate Demand (AD) negatively sloped? Explain.
- ii. "The shape of the Aggregate Supply Curve (AS) is a source of much controversy in Macro Economics. Do you agree? How would the Keynesians differ from Classical in this regard? Explain. **(06 marks)**
- (b) Using AD/AS Framework, explain how the following events would affect level of output and price in an economy.
- i. A reduction in the personal income tax.
 - ii. A considerable increase in the level of exports in a country.
 - iii. Significant improvement in the Capital stock of a country.
 - iv. Reduction in reserve requirement of commercial Banks during a period of high unemployment and excess industrial capacity. **(14 marks)**

Question No. 06

Do you "agree" or "disagree" with the following statements? Explain your answer.

- (a) "\$ 500 billion reduction in taxes is more expansionary than \$ 500 increase in government expenditure" **(05 marks)**
- (b) "Economists differ in their belief as to the level of government intervention in achieving economic growth. Some argue that governments should intervene in the market place if higher economic growth to be achieved. Other Economists argue the government is poorly placed to judge how resources should be allocated within an Economy, therefore government should liberate markets of restrictions. They advocate use of Supply Side policies to increase the rate of Economic Growth." Discuss, providing examples.

(15 marks)**- Rights Reserved -**