

**THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/PUBLIC
ADMINISTRATION PROGRAMME
FINAL EXAMINATION – 2017 JULY
MCP1605 – ECONOMIC ENVIRONMENT OF BUSINESS
DURATION: THREE (03) HOURS**



DATE: 23.07.2017

TIME: 01.30 PM – 04.30 PM

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

Part A

Question No.01

- A. “Floating Exchange Rate System is the most robust”.
- How is the currency value determined under Floating Exchange Rate System? Explain using illustrations.
 - What are the advantages and disadvantages of the Floating Exchange Rate System? Why is the Floating Exchange System the most robust? Explain.
- (07 Marks)**
- B. “Fixed Exchange Rate System is better than the Floating Exchange Rate System, at providing exchange rate stability”.
- How is the currency value determined under Fixed Exchange Rate System? Explain using illustrations.
 - Highlighting advantages and disadvantages of Fixed Exchange Rate System, explain whether you agree with the given statement.
- (07 Marks)**
- C. “It is believed that the government can tackle the persistent current account deficit through devaluation or letting the domestic currency depreciate”.
- How effective is the devaluation /depreciation in tackling the current account deficit? Explain.
 - What are the problems associated with devaluation/depreciation in the short run? Explain with illustrations where appropriate.
 - Sri Lankan rupee has been continuously depreciating against the currencies of its major trading partners, yet the current account deficit has become a permanent feature in its Balance of Payment (BOP) account. Why? Explain.
- (14 Marks)**

D. "Protectionist measures can reduce imports but the ability of governments to implement such policies today is severely limited".

- i. What are the protectionist policies a country can adopt? Explain using illustration where appropriate.
- ii. Do you agree with the above statement? Explain.
- iii. What are the supply side policies available to make domestic industries more competitive?

(12 Marks)

Part B

Question No.02

A. "Although Production Possibility Curve Analysis (PPC) exists only as an abstraction, this analysis is highly useful in explaining many concepts".

Using PPC Analysis, explain the following.

- i. How the availability of capital goods, compared to consumption goods determine the rate of economic growth of a country?
- ii. How the countries can gain from international trade?

(07 Marks)

B. "Externalities are not a minor aspect of market failure and they result in misallocation of resources". Explain whether you "agree" with the given statement, taking following examples into consideration.

- i. Deep sea oil drilling.
- ii. Reduction in diseases and deaths through immunization.
- iii. If the above results in inefficient market outcomes, what solutions are available to make the outcomes efficient? Explain using illustrations.

(08 Marks)

C. "If public goods are not provided by the government, these goods will be under supplied or not supplied at all"

- i. What are the major characteristics of public goods? Explain.
- ii. Using examples explain whether you "agree" or "disagree" with the above statement.

(05 Marks)

Question No.03

A.

- i. Price of “gold” began to rise rapidly and the expectation is that the price will rise further. How will this influence the present market condition for gold? Can this market behavior be considered as an example for exception to the “Law of Demand”? Explain using illustrations.
- ii. “It is quite possible that the labour supply curve could be backward bending” Do you agree? Explain using illustrations.

(06 Marks)

B. Do you “agree” or “disagree” with the following statements. Explain your answer providing illustrations where possible.

- i. If the Price Elasticity of Demand for hard drugs is “-2” the drug enforcement authority could reduce the consumption of hard drugs considerably, by drastically cutting down the supply,
- ii. Consumers prefer that the government impose tax on products that have inelastic demand than elastic demand.

(07 Marks)

C. What is the practical relevance of Income Elasticity of Demand? Explain.

(07 Marks)**Question No.04**

A.

- i. Would a Monopolist produce in the inelastic range of its demand curve? Explain using illustrations.
- ii. “Perfectly Price Discriminating Monopolist will actually produce the efficient quantity of output” Do you agree? Explain using illustrations.

(07 Marks)

B. “Firms that operate in Monopolistically Competitive and Oligopolistic industries aims at achieving high degree of market power through product differentiation and advertizing. However critics argue that product differentiation and advertizing waste society’s scare resources” Elaborate the above statement with examples.

(08 Marks)

C. “Price of the product of Monopolistically Competitive Firms equals the long run average cost and they make zero economic profit”. Would that mean Monopolistically Competitive Firms achieve maximum allocative efficiency in the long run? Explain using illustrations.

(05 Marks)

Question No.05

- A. Using illustrations explain the impact of following changes on the rate of interest in a country.
- i. The income level of people declines.
 - ii. The average price level in the economy increases. **(04 Marks)**
- B. “Monitory policy influences the rate of interest and this intern affects the Aggregate Demand”.
- i. Using illustrations explain how the following changes influence the rate of interest in a country.
 - The Central Bank purchases government bonds and securities through open market operations.
 - The Central Bank increases the reserve requirement of Commercial Banks. **(05 Marks)**
 - ii. How would the expansionary monitory policies affect the level of aggregate demand (planned expenditure)? Explain. **(05 Marks)**
- C. Assume that the economy is initially in the long run equilibrium. Using Aggregate Demand/Aggregate Supply (AD/AS) framework explain the long run impact of the expansionary monitory policy. Provide relevant illustrations. **(06 Marks)**

Question No.06

- A. “Economist generally believes that higher budget deficits today will reduce the growth rate of the economy in the future. However deficit financing has been justified for outlays that increase the country’s productivity”. Do you agree? Explain. **(06 Marks)**
- B. “Impact of interest rate on investments may depend on whether the economy is in recessionary or booming period of the business cycle. Investments may not respond positively to lower interest rate at a time of recession and it may not respond negatively to a high interest rate at a time of boom”.
- i. What are the leading, coincidental and lagging indicators of the Business Cycle? Explain.
 - ii. Explain whether you agree with the above statement. **(07 Marks)**
- C. What are the sources of economic growth? What public policies can be pursued to expedite the level of economic growth of a country? Explain. **(07 Marks)**

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