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**MBA / MPA PROGRAMME COMMONWEALTH
EXECUTIVES**

Term-End Examination

December, 2010

C-5 : ECONOMIC ENVIRONMENT OF BUSINESS

Time : 3 hours

Maximum Marks : 100

(Weightage 70%)

Note : *Attempt any three questions from Section - A and all four questions from Section - B.*

SECTION - A

1. Why should we be concerned about an increase in the unemployment rate ? Briefly explain. 20
2. Show the effect of an increase in the marginal propensity to save on two level of output, prices and the interest rate in the short run (an upwards sloping Aggregate Supply Curve) and in the long (a Vertical Aggregate Supply Curve) with the help of an IS-LM, AD - AS diagram. 20
3. Define Efficiency wage theory. What does the efficiency wage represent ? Explain . 20

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4. Does your country's balance of payments account show a deficit or a surplus ? How about your country's capital account ? What is the situation like from the perspective of the individual components of the current account ? Briefly explain. **20**
5. Write short notes on *any four* of the following : **5x4=20**
- (a) Tradable and non-tradable goods and services
 - (b) Currency Devaluation and currency depreciation
 - (c) Interest rate Parity theory
 - (d) Consumption multiplier
 - (e) The crowding-out effect on investment
 - (f) Market failure and Government failure

SECTION - B

6. Four friend operates a variety store that generates an annual revenue of \$ 480,000. Each year he pays \$ 25,000 in rent for the store, \$15,000 in business taxes, and \$ 350,000 on products to sell. He estimates he could put the \$ 80,000 he has invested in the store into his friend's restaurant business instead and earn an annual 20 percent profit on his funds. He also estimates that he and his family could earn a total annual wage of \$ 90,000 if they worked some where other than the store. 2x5=10

- (a) Calculate the total explicit costs and total implicit costs of running the variety store.
- (b) What is the accounting profit of the variety store ?
- (c) What is the economic profit ?
- (d) In what way is economic profit superior to accounting profit as an indicator of the overall performance of this business ? Given the advantages of economic profit as a performance indicator, explain why the concept of economic profit is not often used in accounting ?
- (e) Should your friend consider closing down this business, why ?

7. Assuming a Toyota dealer in India bought 30 Toyotas directly from Japan at a cost of \$10,000 per car in the fall of 2001. By December 31, 2001 the dealer sold 20 Toyotas for \$ 13,000 each. The remaining 10 Toyotas were sold in 2002 for \$ 12,000 each. How are the GDP and its major components affected in 2001 and in 2002 ? 10

8. The long-run supply curve for a particular type of kitchen knife is a horizontal line at a price of \$ 3 per knife. The demand curve for such a kitchen knife is 10

$$Q_d = 50 - 2P$$

Where Q_d is the quantity of knives demanded (in millions per year) and P is the price per knife (in dollars)

- (a) What is the equilibrium output of such knives ? 4
- (b) If a tax of \$ 1.00 is imposed on each knife, what is the equilibrium output of such knives ? (Assume that the tax is collected by the government from the suppliers of knives) 3
- (c) After the tax is imposed you buy such a knife for \$ 3.75. Is this the long-run equilibrium price ? 3

9. The marketing manager of the 'Ajita's Company' must formulate a recommendation concerning the price to be charged for a new product. According to last available estimates, the marginal cost of the new product will be \$ 18, and the price elasticity of demand for this product will be 3.0

- (a) What recommendation should she make, if ^{2x5=10} Ajita wants to maximize profit ?
- (b) If her recommendation is accepted, what will be the new products marginal revenue ?
