FINAL EXAMINATION

BUSINESS ECONOMICS

Part A

Case Study One:

Question #1:

YTL did not buy property during inflationary period. Identify the reasons given by Tan Sri Dr. Francis Yeoh for not buying property by YTL during inflationary period

Answer:

YTL Corp Bhd is not buying any assets at the moment due to inflationary pressure, says group managing director Tan Sri Dr Francis Yeoh. "The environment is very difficult for YTL to buy assets, because all these assets are inflated," he said. "From 2008 till today there is nothing major that we can acquire," he said at the Global Malaysia Series talk yesterday. He explained that the United States and the European countries had introduced inflation to the world but not in their own economics, by printing money. Warning that the global bubble would burst within two to four years, he said that this would be the first government-led bubble created by the US and European governments.

Question #2:

Productivity does not increase when wages (salary) increased during inflation. Assess the statement with examples

Answer:

Wage push inflation is an overall rise in the cost of goods and services that results from a rise in wages. To maintain corporate profits after an increase in wages, employers must increase the prices they charge for the goods and services they provide. The overall increased cost of goods and services has a circular effect on the wage increase; eventually, as goods and services in the market overall increase, higher wages will be needed to compensate for the increased prices of consumer goods.

Companies can increase wages for a number of reasons. The most common reason for raising wages is an increase in the minimum wage. The federal and state governments have the power to increase the minimum wage.

Consumer goods companies are also known for making incremental wage increases for their workers. These minimum wage increases are a leading factor for wage push inflation. In consumer goods companies especially, wage push inflation is highly prevalent, and its effect is a function of the percentage increase in wages.

Question #3:

Compare and contrast a scenario when the rate of productivity could be increased higher than the rate of increase in wages to the workers (your answer should not be less than **500 words**)

Answer:

Markets for labour have demand and supply curves, just like markets for goods. The law of demand applies in labour markets this way: A higher salary or wage—that is, a higher price in the labour market—leads to a decrease in the quantity of labour demanded by employers, while a lower salary or wage leads to an increase in the quantity of labour demanded. The law of supply functions in labour markets, too: A higher price for labour leads to a higher quantity of labour supplied; a lower price leads to a lower quantity supplied.

In the labour market, households are on the supply side of the market and firms are on the demand side. In the market for financial capital, households and firms can be on either side of the market: they are suppliers of financial capital when they save or make financial investments, and demanders of financial capital when they borrow or receive financial investments.

In the demand and supply analysis of labour markets, the price can be measured by the annual salary or hourly wage received. The quantity of labour can be measured in various ways, like number of workers or the number of hours worked.

Labour is not the only input into the production process. For example, a salesperson at a call centre needs a telephone and a computer terminal to enter data and record sales. The demand for salespersons at the call centre will increase if the number of telephones and computer terminals available increases. This will cause a rightward shift of the demand curve. As the number of inputs increases, the demand for labour will increase. If the terminal or the telephones malfunction, then the demand for that labour force will decrease. As the quantity of other inputs decreases, the demand for labour will decrease. Similarly, if prices of other inputs fall, production will become more profitable and suppliers will demand more labour to increase production. The opposite is also true. Higher input prices lower demand for labour

Factors that can shift the demand curve for labour include: a change in the quantity demanded of the product that the labour produces; a change in the production process that uses more or less labour; and a change in government policy that affects the quantity of labour that firms wish to hire at a given wage. Demand can also increase or decrease (shift) in response to: workers' level of education and training, technology, the number of companies, and availability and price of other inputs.

The main factors that can shift the supply curve for labour are: how desirable a job appears to workers relative to the alternatives, government policy that either restricts or encourages the quantity of workers trained for the job, the number of workers in the economy, and required education.

Government policies can also affect the supply of labour for jobs. On the one hand, the government may support rules that set high qualifications for certain jobs: academic training, certificates or licenses, or experience. When these qualifications are made tougher, the number of qualified workers will decrease at any given wage. On the other hand, the government may also subsidize training or even reduce the required level of qualifications. For example, government might offer subsidies for nursing schools or nursing students. Such provisions would shift the supply curve of nurses to the right. In addition, government policies that change the relative desirability of working versus not working also affect the labour supply. These include unemployment benefits, maternity leave, child care benefits and welfare policy. For example, child care benefits may increase the labour supply of working mothers. Long term unemployment benefits may discourage job searching for unemployed workers. All these policies must therefore be carefully designed to minimize any negative labour supply effects.

Case Study Two:

<u>Question #1:</u>

In the above case study, identify TWO factors that are responsible for the rise in Japan's Gross Domestic Product (GDP).

<u>Answer:</u>

The upturn in capital spending - long a weak spot in Japan - could raise hopes the economy will have enough momentum to tide over an expected slump following an April 1 sales tax hike, easing pressure on the Bank of Japan for further stimulus to support growth

Still, analysts also say the economy faces the risks in coming quarters of consumer demand not bouncing back convincingly after the sales tax increase and exports staying weak. "Corporate earnings have been improving and some facilities have been ageing, so some firms felt they could not delay capital expenditure any longer," said Norio Miyagawa, a senior economist at Mizuho Securities Research & Consulting Co.

<u>Question #2:</u>

Critically evaluate the impending rise of sales tax planned by the Japanese government and its effect on the demand and eventually public spending.

<u>Answer:</u>

Japan's experience in raising the consumption tax will set an important example for other countries. Many advanced economies face the same challenge to lower public debt ratios over the medium term and address rising social security spending while at the same time preserving growth—but they will face it somewhat later, making Japan something of an early test case. For these economies, raising the consumption tax could also generate significant revenue while addressing some of the imbalances arising from an aging population.

At 5 percent, the rate of the consumption tax (value added tax, VAT) is among the lowest in the world,2 and well below the European average of 20 percent. For aging societies like Japan, increasing revenue from raising the VAT is especially appealing for a number of reasons:3 it provides a stable source of revenue in an aging society (consumption being smoother than, for instance, income); it distributes the tax burden more equitably across current cohorts (ensuring that those entering retirement pay a fair share toward the cost of their retirement support); and, the evidence suggests, is less detrimental to growth compared with other taxes. While the economic merits for raising the VAT are reasonably clear, a political consensus for action has yet to emerge.4 But the picture may now be changing, with recent polls, including those after the earthquake, showing growing public support for raising taxes not just to defray the near-term cost of reconstruction but also to pay for social security.

Question #3:

In your opinion, the above rise in GDP is sustainable. Give your explanations to support your opinion (your answer should not be less than **500 words**)

Answer:

Economic growth has raised living standards around the world. However, modern economies have lost sight of the fact that the standard metric of economic growth, gross domestic product (GDP), merely measures the size of a nation's economy and doesn't reflect a nation's welfare. Yet policymakers and economists often treat GDP, or GDP per capita in some cases, as an all-encompassing unit to signify a nation's development, combining its economic prosperity and societal well-being. As a result, policies that result in economic growth are seen to be beneficial for society.

We know now that the story is not so simple – that focusing exclusively on GDP and economic gain to measure development ignores the negative effects of economic growth on society, such as climate change and income inequality. It's time to acknowledge the limitations of GDP and expand our measure development so that it takes into account a society's quality of life.

A number of countries are starting to do this. India, for instance, where we both work advising the government, is developing an Ease of Living Index, which measures quality of life, economic ability and sustainability.

When our measures of development go beyond an inimical fixation towards higher production, our policy interventions will become more aligned with the aspects of life that citizens truly value, and society will be better served. But before we attempt to improve upon the concept of GDP, it is instructive to understand its roots.

But a measure created to assess wartime production capabilities of a nation has obvious drawbacks in peacetime. For one, GDP by definition is an aggregate measure that includes the value of goods and services produced in an economy over a certain period of time. There is no scope for the positive or negative effects created in the process of production and development.

For example, GDP takes a positive count of the cars we produce but does not account for the emissions they generate; it adds the value of the sugar-laced beverages we sell but fails to subtract the health problems they cause; it includes the value of building new cities but does not discount for the vital forests they replace. As Robert Kennedy put it in his famous election speech in 1968, "it [GDP] measures everything in short, except that which makes life worthwhile."

Environmental degradation is a significant externality that the measure of GDP has failed to reflect. The production of more goods adds to an economy's GDP irrespective of the environmental damage suffered because of it. So, according to GDP, a country like India is considered to be on the growth path, even though Delhi's winters are increasingly filled with smog and Bengaluru's lakes are more prone to fires. Modern economies need a better measure of welfare that takes these externalities into account to obtain a truer reflection of development.

Broadening the scope of assessment to include externalities would help in creating a policy focus on addressing them.

GDP also fails to capture the distribution of income across society – something that is becoming more pertinent in today's world with rising inequality levels in the developed and developing world alike. It cannot differentiate between an unequal and an egalitarian society if they have similar economic sizes. As rising inequality is resulting in a rise in societal discontentment and increased polarization, policymakers will need to account for these issues when assessing development.

Another aspect of modern economies that makes GDP anachronistic is its disproportionate focus on what is produced. Today's societies are increasingly driven by the growing service economy – from the grocery shopping on Amazon to the cabs booked on Uber. As the quality of experience is superseding relentless production, the notion of GDP is quickly falling out of place. We live in a world where social media delivers troves of information and entertainment at no price at all, the value for which cannot be encapsulated by simplistic figures. Our measure of economic growth and development also needs to adapt to these changes in order to give a more accurate picture of the modern economy.

Part B

Question #1:

Managerial economic decisions are an important component in achieving the objectives of the organization. The success or failure of a business depends upon the decisions made by managers. Define the importance of managerial economics in the context of business organization.

Answer:

Importance of managerial economics in a business and industrial enterprise as follows:

- **Accommodating traditional theoretical concepts to the actual business behavior and conditions**

  Managerial economics amalgamates tools, techniques, models and theories of traditional economics with actual business practices and with the environment in which firm has to operate. According to Edwin Mansfield, "Managerial Economics attempts to bridge the gap between purely analytical problems that intrigue many economic theories and the problems of policies that management must face".
- **Estimating economic relationships**

  Managerial economics estimates economic relationships between different business factors such as income, elasticity of demand, cost volume, profit analysis etc.

- **Predicting relevant economic quantities**

  Managerial economics assist the management in predicting various economic such as cost, profit, demand, capital, production, price etc. As a business manager has to function in an environment of uncertainty, it is imperative to anticipate the future working environment in terms of the said quantities

- **Understanding significant external forces**

  The management has to identify all the important factors that influence a firm. These factors can broadly be divided into two categories. Managerial economics plays an important role by assisting management in understanding these factors

- **Basis of business policies**

  Managerial economics is the founding principle of business policies. Business policies are prepared based on studies and findings of managerial economics, which cautions the management against potential upheavals in national as well as international economy.
  Thus, managerial economics is helpful to the management in its decision-making process.

Question #2:

Monopolies are firms who dominate the market. A monopoly tends to set higher prices than a competitive market, leading to a lower consumer surplus. However, on the other hand, monopolies can benefit from economies of scale, leading to lower average costs, which can, in theory, be passed on to consumers. Distinguish between monopoly, pure monopoly and bilateral monopoly by providing specific support for your claim.

Answer:

Monopoly	Pure Monopoly	Bilateral Monopoly
• A monopoly exists when a single entity is the sole provider of a particular asset or service. • A single individual, company, or group becomes large enough to own all or nearly all of the supply of goods, commodities, facilities, amenities, or support systems. • No competition exists, as only one seller is present in the market.	• A pure monopoly is a single supplier within a defined market or industry. • The firm effectively is the industry in this situation • The nature of the market is that no close competitor or substitute exists • High trade barriers which give increased monopoly power to a domestic firm protected by import tariffs	• A bilateral monopoly exists when a market has only one supplier and one buyer. • The one supplier will tend to act as a monopoly power and look to charge high prices to the one buyer. • There is a small contained market, which limits the number of players, or when there are multiple players but the costs to switch buyers or sellers is prohibitively expensive.

Question #3:

In a market economy, the compensation of labour is determined by the interaction of demand and supply in each labour market, relative compensation by the interaction of relative demand and supply. A higher price for labour leads to a higher quantity of labour supplied, a lower price leads to a lower quantity supplied and prices and wages help coordinate economic activities. Do you agree this statement if so, why?

Answer:

Shifts in Labour Demand:

A change in the wage or salary will result in a change in the quantity demanded of labour. If the wage rate increases, employers will want to hire fewer employees. The quantity of labour demanded will decrease, and there will be a movement upward along the demand curve. If the wages and salaries decrease, employers are more likely to hire a greater number of workers. The quantity of labour demanded will increase, resulting in a downward movement along the demand curve.

One key reason is that the demand for labour is based on the demand for the good or service that is being produced. For example, the newer automobiles consumers demand, the greater the number of workers automakers will need to hire. Therefore, the demand for labour is called a "derived demand." Here are some examples of derived demand for labour:

- The demand for chefs is dependent on the demand for restaurant meals.
- The demand for pharmacists is dependent on the demand for prescription drugs.
- The demand for attorneys is dependent on the demand for legal services.

Shifts in Labour Supply

The supply of labour is upward-sloping and adheres to the law of supply: The higher the price, the greater the quantity supplied and the lower the price, the less quantity supplied. The supply curve models the trade-off between supplying labour into the market or using time in leisure activities at every given price level. The higher the wage, the more labour is willing to work and forego leisure activities.

Question #4:

The theory of price adjustment has been dominated by the idea that prices rise in the presence of excess demand and fall in the presence of excess supply. Discuss the two adjustments of long period monopoly price in the current scenario.

Answer:

Single-Plant Adjustment:

If the monopolist runs on a single plant, there are three possibilities: If the monopolist is losing money in the short term, he can make changes to his plant to prevent losses in the long run. In order to make money, he may have a plant that isn't the optimal size. If he can't, he'll have to quit making everything. (ii) He could have a plant that is bigger than it needs to be.

This plant, however, is not the optimal size since the monopolistic business is not producing at the LAC curve's lowest point, L. It has considerable capacity left over. Due to the tiny size of the market for its goods, it is unable to fully benefit from economies of scale

Multi-Plant Adjustments:

A monopolist may own and run multiple plants. In the short term, he can run any number of plants, whether they are the same size or various sizes. However, in the long term, he only runs the plants that bring in the most money. Given similar cost circumstances and the same size plants, he will have each plant of that size where the long-run average cost curve LAC and the short-run average cost curve SAC touch at their minimal points.

If the monopolist operates four plants in the short run, he may reduce them to two in the long run by using more efficient plants, lowering the long-run average and marginal costs, and increasing profits. The multi-plant monopoly adjustment, like the single-plant monopoly, may be followed by quantity and price adjustments in the long term. In the event of a multi-plant monopoly, however, the company will operate at the lowest long-run average costs in order to maximize earnings.