

FACULTY OF MANAGEMENT STUDIES

UNIVERSITY OF DELHI

Semester Examination 2014

Name of Examination.....MBA Full Time March 2014.....

Paper Name...ECONOMIC ENVIRONMENT OF BUSINESS.....Paper No.6203..... Option.....

Time allowed.....3...Hours Maximum Marks.....50.....

Instructions to candidates regarding the number of questions to be answered etc. should be indicated in space provided below.

This is a closed book examination. Calculators are allowed. There are a total of six questions. Answer any five.

Serial No. of Question	Answer any five questions out of six. All questions carry equal marks.	Mark:
1.	<p>(a) What is income velocity of money? What is the relation (if at all) between velocity and overall money demand? Why does Central Bank monitor the velocity?</p> <p>(b) Consider an economy with autonomous monetary authority where the Central Bank is planning to conduct an open-market operation by buying bonds. Explain the transmission mechanism through which this change is going to impact the equilibrium output and interest rate. Show the mechanism in an appropriate graph. What makes monetary policy more effective?</p>	4+6
2.	<p>You are given the following information about an economy's goods market and money market:</p> <p>Consumption function, $C = 2,180 - 20i + 0.6Y_D$, where Y_D: disposable income</p> <p>Investment demand, $I = 2,400 - 60i$</p> <p>Government spending, $G = 2,000$</p> <p>Net exports, $NX = -300$</p> <p>Taxes, $T = 1,800$</p>	4+

Taxes, $T = 1,800$

Transfers, $TR = 0$.

Demand for real money, $M^d/P = 0.25Y - 50i$

Supply of real money, $M^s/P = 2,750$.

- (a) Find out the Government expenditure multiplier. Also find the slopes of the IS and LM curves.
- (b) Find the equilibrium for the goods and the money market. Show in a graph.
- (c) During an election year, the ruling party is contemplating a fiscal stimulus to increase equilibrium output by 10%. Government can either increase its spending (G) or decrease tax (T). Does it matter whether Government uses G or T for the fiscal stimulus? Suggest a suitable policy. Support your suggestion quantitatively as well as qualitatively.

3.

Consider an economy with the following aggregate demand (AD) and short-run aggregate supply (SRAS) curves:

AD: $Y = 1.25A_0 + 2.5 M_s/P$

SRAS: $Y = 11,250 - 20W + 1,000P$

where Y is the real GDP and P is the price level.

Autonomous spending, $A_0 = 5,000$

Nominal Money Supply, $M_s = 2,000$

Nominal Wage, $W = 50$.

Also the natural level of output for this economy, $Y_n = 12,250$.

- (a) Determine the short-run equilibrium of this economy. Show in a graph.
- (b) Determine the long-run equilibrium of this economy. Discuss the transition (if any) from short-run to the medium/long-run. Show in a graph.
- (c) Explain using the AD/AS graphs what will happen if there is now nominal money supply is changed to 3,000. Explain the transition. Also show in a graph.

3+3+4

4.

- (a) What is the natural level of unemployment?
- (b) Discuss separately how the following changes would affect the natural rate of unemployment:
 - i. Elimination of labor unions
 - ii. Increased participation of teenagers in labor market.
- (c) Stagflation refers to a situation in an economy where we observe high unemployment and high inflation at the same time. Can you explain this empirical observation using the augmented Philips Curve?

2+4+

Or,
(If you choose the previous question, do all three parts. If you choose the following question, do all three parts)

You have the following information about an economy:

	2011-12	2012-13	2013-14
Real GDP in billion USD	5,000	4,700	4,000
Price Index	475	500	520
Unemployment rate	4%	6%	8%

- What are the economic problems in this economy?
- Recommend fiscal policy to address the problems. What are the goals of your fiscal policy? Use an appropriate demand and aggregate supply graph to show the effects of your fiscal policy on the price level and the level of real GDP. Consider short-run only.
- Is fiscal policy the best tool to address the current set of problems? Suggest alternative policy (if any)

- In open economy, reserve money also consists of foreign exchange assets. What will then be the impact of an increase in country's net foreign exchange on money supply and output? Use the Mundell-Fleming model to answer this question.
- China is said to be artificially depreciating its currency, yuan, with respect to U.S. dollar. Using the Mundell-Fleming model, show graphically the current Chinese equilibrium by drawing the IS, LM and the BP curve in the same graph.
- Suppose now China revalues its currency. What will be the impact on the interest rate, output, BP surplus? Explain using appropriate graphs.

Write short notes of *any two*

- WPI versus CPI in the Indian context,
- GDP as a measure of welfare,
- Market and non-market failures in the context of Indian Liberalization since 1991.