

MBA(FT) – March 2016
MBAFT-6203
Paper Title: Economic Environment of Business

Time : 3 Hours

Max. Marks : 50

Instructions

This is a closed book examination. Calculators are allowed. Answer any five out of six questions. All questions carry equal 10 marks

1. The following questions summarize an economy:

$$C = Ca + 0.85(Y - T)$$

$$Ca = 260 - 10i$$

$$T = 200 + 0.2Y$$

$$M_d/P = 0.25Y - 25i$$

$$M_s/P = 2,125$$

$$I = 1,500 - 30i$$

$$G = 1,700$$

$$NX = 500 - 0.08Y,$$

where Y stands for domestic income, C stands for consumption demand, I stands for investment demand, T stands for taxes, G stands for Government expenditure, NX stands for net exports, M_d stands for nominal money demand, M_s stands for nominal money supply, i stands for interest rate, P stands for price level.

- Compute the value of Government Expenditure multiplier.
- Show the IS and LM curves graphically. Calculate the slope of the IS curve.
- The Government now increases spending by 160. What should the Central Bank of the country do to completely nullify the effect of crowding out? Explain. Show graphically. Answer numerically. Also mention the assumptions that you are making for your policy suggestion to work.

2+4+4

2. Paul Krugman made the following statement regarding the Japanese Economy in 1998: "Japan is an economy that is almost certainly producing well below its productive capacity - that is, the immediate problem facing Japan is one of demand, not supply. And it gives every appearance of being in a liquidity trap - that is, conventional monetary policy appears to have been pushed to its limits, yet the economy remains depressed. What can be done?"
 - What is this *liquidity trap* mentioned by Professor Krugman? Explain the phenomenon in this particular context using appropriate graph.
 - Suggest fiscal policies and/or monetary policies that can help. Use appropriate framework and graphs to explain how the policies suggested by you is going to have an impact. State your assumptions clearly.

- iii. Suggest other economy-wide reforms (other than fiscal and monetary) that can help.

2+4+4

3. i. What is Gini Coefficient? Explain its importance.
ii. A recent report in a leading Indian newspaper reads as follows: "French economist Thomas Piketty says he hopes the Indian elite will pay more taxes on wealth and income, as the country's tax-to-GDP ratio of less than 11 per cent is insufficient to meet its challenges of inequalities. The aim should be to evolve the ratio towards 30-50 per cent, as in the U.S. and west European countries. India has zero wealth tax... I hope the Indian elite will behave much more responsibly [in paying more taxes] than the western elite did in the 20th century," he told
The current tax-to-GDP ratio — of between 10 per cent and 11 per cent — is insufficient for meeting India's huge challenges of inequalities, the French economist said. The aim should be to evolve the ratio toward the 30 per cent to 50 per cent levels now seen in the U.S. and some of the West European countries.
"I hope Indian elite will behave much more responsibly than the western elite did in the 20th century.... True reforms are yet to come in the public funding of the education system and improvement in the transparency in the tax collection system has not happened yet," Mr. Piketty said"

In this article Professor Piketty seems to be suggesting that taxing the rich and redistributing that wealth will be beneficial for India. One can argue instead that economic wellbeing is more about raising the income level for everyone, i.e., achieve higher growth to attain higher income per capita, and inequality should not be a prime concern. Discuss the two viewpoints. What is your take on this issue in the context of a poor developing economy?

3+7

4. "In the context of India's fiscal framework, attaining fiscal consolidation remains important. One way to achieve these targets will be *expenditure control* and *expenditure switching* from consumption to investment".
- i. In light of the above statement, comment on the role of:
a. Tax *bouyancy*, and
b. Expenditure control
to ensure that medium term fiscal targets are comfortably met.
(Definition: A tax is said to be *bouyant* if the tax revenues increase more than proportionately in response to a rise in national income.)
- ii. To what extent has the Union Budget 2016-17 met the fiscal consolidation targets? Examine critically.

5+5

- fixed
+ flexible*
5. With reference to the Mundell-Fleming model, starting from an initial equilibrium, suppose an expansionary fiscal policy is adopted by country H :
- What is the impact of this policy on the IS and LM curves? Explain and illustrate.
 - What is the short-run impact on Balance of Payment? Explain and illustrate.
 - What will be the impact on domestic currency in the foreign exchange market? Assume that only country H is adopting this policy while other countries are maintaining status quo.
 - If there is a flexible exchange-rate regime, what should H do to restore the initial equilibrium?

3 + 2 + 2 + 3

6. Write comments on any *two*:
- Impact of an income tax hike in the AD/AS framework.
 - The natural level of output and the natural level of unemployment.
 - Transmission mechanism of expansionary monetary policy.

5 + 5