

MBA FT
I Year II Semester
Paper FT: 6203
Economic Environment of Business
Maximum Time: 3 Hours
Maximum Marks: 50

NOTE:

- a. Attempt a total of FIVE Questions
- b. Question Number 1 is compulsory
- c. All Questions carry equal marks

Question 1

Compare the views of Keynes and the classical economists with regard to employment, output determination and the proper role of government. Explain why Keynes rejected the views of the classical economists. Do you think that the views of Keynes and classical economists also differed with respect to determination of price/inflation?

OR

Assume that the economy of Country Z is operating on the upward-sloping portion of its short-run aggregate supply curve. Assume that the government increases spending.

- a) How will the increase in government expenditures affect each of the following in the short run?
 - i. Aggregate demand
 - ii. Short-run aggregate supply
- b) Using a correctly labeled graph of aggregate demand and aggregate supply, show the effect of the increase in government expenditures on real output and the price level.
- c) Assume that the government funded this increase in expenditure by borrowing from the public. Using a correctly labeled graph, show the effect of the increase in government borrowing on the real interest rate.
- d) Given the change in the real interest rate in part (c), what will be the effect on each of the following on the foreign exchange market?
 - i. Supply of Country Z's currency. Explain.
 - ii. The value of Country Z's currency

- e) Given your answer in part (d) (ii), what will be the effect of the change in the value of Country Z's currency on Country Z's exports? Explain.

Question 2

- a. Explain the mechanism of Keynesian government expenditure multiplier to show that multiplier depends on the marginal propensity to consume.
- b. How does an increase in the marginal propensity to consume affect the slope of IS curve? Does the slope of IS curve affect the effectiveness of monetary policy?

Question 3

- a. If RBI is of the opinion that the economy needs more liquidity, what sort of Open Market Operations (OMO) should it conduct to achieve that? In the context of IS-LM analysis, draw appropriate graphs and explain the transmission mechanism in a closed economy. Additionally, derive the magnitude of the monetary policy multiplier.
- b. At the time of the above mentioned OMO, suppose the commercial banks are burdened with a lot of bad loans and, hence, do not wish to give out any new loans. Explain how this will impact the goal of the OMO.

Question 4

- a. How does the Real Business Cycle (RBC) Theory explain the short-run output fluctuations in an economy?
- b. Proponents of RBC theory propose that markets always clear since price and wages adjust instantly in response to shocks. Critics of RBC claim that wages and prices are sticky. Discuss two different theories of price/wage stickiness that will prevent instantaneous adjustments.

OR

- a. What are market and non-market failures? The economic reforms initiated by India in the early 1990s addressed which of these failures.
- b. What is GDP? Recently, India changed its GDP calculation method by switching to market price calculation. What effect has this had on India's GDP growth rates? GDP data are, in practice, used not only as a measure of how much is being produced, but also as a measure of the welfare of the residents of the country. Economists and politicians

talk as if an increase in real GDP means that people are better off. But it is often said that GDP data are far from perfect measures of either economic output or welfare. Comment.

Question 5

- a. Derive the saving- investment identity in the context of an open economy. From national income accounting, show that an increase in taxes (while transfers remain unchanged) must imply a change in net exports, government purchases or the saving investment balance.
- b. Can a cut in the tax rate cure inflation? Explain your stance. Mention some of the tools/steps that can be taken by the Government of India and its Central Bank to control inflation?

Question 6

Write notes on:

- i. Expansionary fiscal policies in the context of Mundell-Fleming Model under fixed and flexible exchange rate regimes
- ii. Critical analysis of India's Union Budget 2015-16

OR

- i. "A political mandate for reform and a benign external environment have created a historic moment of opportunity to propel India onto a double-digit growth trajectory. Decisive shifts in policies controlled by the Centre combined with a persistent, encompassing, and creative incrementalism in other areas could cumulate to Big Bang reforms".

Source: Economic Survey, 2014-15, GOI, Chapter 1

Critically analyze the above statement in the context of manufacturing, services and the challenges of "Make in India".

- ii. Write a note on speculative motive for holding money.
