[This question paper contains 4 printed pages.]

4203

Your Roll No. ....

MBA (FT) **A**

Paper MBAFT – 6203 – ECONOMIC ENVIRONMENT OF BUSINESS

(Admissions of 2010 and onwards)

Time : 3 Hours *Maximum Marks : 50*

(Write your Roll No. on the top immediately on receipt of this question paper.)

Note: Attempt a Total of Five Questions. Question 1 is Compulsory. Marks are indicated next to each question.

Question 1 (Compulsory)

Attempt any two of the following:

a) Not all economists buy the Keynesian story that a cut in government spending reduces income, claiming that the multiplier is in effect zero, thanks to falling interest rates and a falling dollar.

- How would falling interest rates come about?
- How would a falling dollar come about?
- How could this cause the multiplier to be zero?

b) Years of high growth generally _______ inflation, which in turn prompts the Federal Reserve to ________ interest rates, a step that runs the risk of triggering _________ .

Fill in the blanks and explain the logic behind filling the blanks.

c) There is no historical evidence of countries finding enduring prosperity in a strategy of currency devaluation: We cannot devalue our way to the kind of competitive, high-performance economy we want. Do you agree with the stated view? Justify your stance.

5+5=10 Marks

Question 2

a) Using the IS-LM analysis, illustrate and explain the case "Money Does Not Matter".

b) Using the formal analysis of the IS-LM model show that the equilibrium rate of interest depends on the parameters of fiscal policy captured in the multiplier and the term A (autonomous expenditure) and on the real money stock.

In other words, prove that:

P.T.O.

$$i = \frac{k}{h}\gamma\bar{A} - \frac{1}{h + kb\alpha_G}\frac{\bar{M}}{\bar{P}}$$

5+5=10 Marks

Question 3

Economist Alan Blinder, whom Bill Clinton appointed to be Vice Chairman of the Federal Reserve, once wrote the following:

'The costs that attend the low and moderate inflation rates experienced in the United States and in other industrial countries appear to be quite modest-more like a bad cold than a cancer on society... As rational individuals, we do not volunteer for a lobotomy to cure a head cold. Yet, as a collectivity, we routinely prescribe the economic equivalent of lobotomy (high unemployment) as a cure for inflationary cold'.

(Cited from: Alan Blinder, Hard Heads, Soft Hearts: Tough-Minded Economics for a Just Society, Addison-Wesley, 1987, pp 51)

What do you think Blinder meant by this? What are the policy implications of the viewpoint Blinder is advocating? Do you agree? Why or why not? (While developing your argument, use of formal concepts/diagrams/equations will be appreciated).

10 Marks

Question 4

Attempt the following:

a) How does the value of marginal propensity to consume affect the slope of the IS curve? Illustrate the same graphically also.

b) What do you understand by Supply Side Economics? Examine the role of Laffer curve in understanding the supply side economics.

5+5=10 Marks

Question 5

Part a

In a closed economy with flexible prices we have the following economic relationships:

IS curve: Y=105 - 0.5i

LM curve: Y = 2(M/P) +2i

Production function: $Y = (80L)^{1/2}$ (Where L=employment)

Note that at full-employment: L=125

Calculate the price level in general equilibrium for this economy when the central bank sets the quantity of nominal money (M) equal to 80.

Part b

Making use of the IS-LM framework, comment on the impact of investment subsidy on equilibrium output, interest and private investment.

5+5=10 Marks

Question 6

Part a

'The simultaneous occurrence of high food inflation and large foodgrain stocks in our granaries has been a matter of concern'.

Kaushik Basu (2011), India's Foodgrain Policy: An Economic Theory Perspective, Economic & Political Weekly, EPW January 29, 2011 vol xlvi no 5, pp 37

In light of this statement comment on the fundamentals of our foodgrain market and policies that led to this situation. Also suggest policies for rectifying this.

Part b

Assume that the capital is perfectly mobile, the price level is fixed, and the exchange rate is flexible. Now let the government increase purchases. Explain the effect of this on equilibrium level of output and interest rate. Does this policy improve or worsen the current account? Why?

5+5=10 Marks

Question 7

Part a

'When the crisis first broke internationally, within official circles in India there was a perception that the Indian economy would be less affected and the Indian financial sector would be relatively immune to the winds from the international financial implosion.... However, ... these expectations have been belied, with sharp changes not only in real economic indicators, but also in financial variables'.

(Cited from: Jayati Ghosh and C. P. Chandrasekhar (2009), "The costs of 'coupling': the global crisis and the Indian economy", Cambridge Journal of Economics, Volume 33)

In light of the above statement, comment on the extent to which India was impacted by the crisis and the fiscal and monetary stimulus packages adopted by India to mitigate the potential threat of the recession.

Part b

As reported in the Economic Times of February 11, 2011, growth in industrial output, as measured by the index of industrial production (IIP), slowed to 1.6 per cent in December, 2010, the lowest pace of expansion in the last 20 months. However, as per Planning Commission Deputy Chairman Montek Singh Ahluwalia, "Month-to-month variation in IIP should not occupy us too much." Do you agree with his view? Justify your stance.

7+3=10 Marks