

**MBA / MPA PROGRAMME COMMONWEALTH
EXECUTIVE**

00294

Term-End Examination

June, 2010

C-5 : Economic Environment of Business

Time : 3 hours

Maximum Marks : 100

(Weightage 70%)

Note : *Attempt any three questions from Section - A and all
four questions from Section - B.*

SECTION - A

1. How will the following transactions affect GDP ? **4x5=20**
- (a) The members of Parliament vote for an increase in their salary effective immediately.
 - (b) You sell your macroeconomics notebook to an underclass student.
 - (c) You sell your holdings of IBM stock.
 - (d) Your local car dealership decides to reduce its inventory by offering additional sales incentives.

2. Explain how a competitive, profit maximizing firm decides how much of each factor of production to demand ? 20
3. Identify the impact of each of the following trends on aggregate demand. In each case, draw a graph to show the effect on the aggregate demand curve as well as on the equilibrium price level and real output. 5x4=20
- (a) Consumers become more confident about the prospects for output growth in the economy.
 - (b) Interest rates rise.
 - (c) Political pressure causes an increase in tax rates on households earning high incomes.
 - (d) Oil prices rise everywhere.
 - (e) The local currency rises in value against the currency of the trading partners.
4. Suppose banks install automatic teller machines on every block and, making cash readily available, reduce the amount of money people want to hold.
- (a) Assume the Central Bank does not change the money supply. According to the theory of liquidity preference, what happens to the interest rate ? What happens to aggregate demand ? 2x10=20
 - (b) If the Central Bank wants to stabilize aggregate demand, how should it respond ?

5. Write short notes on *any four* of the following : 4x5=20
- (a) Whole sale price index and GDP deflator
 - (b) Price rise and Inflation.
 - (c) Cross - Price Elasticity.
 - (d) Aggregate Demand and Aggregate Supply.
 - (e) 'Rajdhani Express' train as a discriminatory monopolist.
 - (f) The purchasing power parity.

SECTION - B

6. Pricing Kabab at the Karim's Restaurant : $4 \times 2.5 = 10$

If you want a Kabab in New Delhi, a top notch place to go is the Karim's restaurant, owned by the 'Karim Hotel Pvt. Limited', which has eleven Karim's restaurants in ten cities, all with the same recipe. The price of a plate of Kabab at each of these eleven restaurants in 2008 is shown below :

New Delhi	Rs. 27.00
Kolkata	Rs. 22.00
Mumbai	Rs. 26.00
Jaipur	Rs. 24.00
Ahmedabad	Rs. 24.00
Goa	Rs. 24.50
Bangalore	Rs. 25.00
Hyderabad	Rs. 26.00
Indore	Rs. 23.00
Patna	Rs. 23.00

- (a) According Mr. Safid Khan, the co-owner of the 'Karim Hotel Pvt. Limited', "people are very price sensitive in Kolkata, and our manager there knows what we have to charge to be competitive". Assuming that the market of restaurant food is monopolistically competitive in each of these cities, is the demand curve for Kabab at the Karim's restaurant in Kolkata the same as that at the Karim's restaurant in New Delhi ? If not, how does it differ ?

- (b) Mr. Khan also states that "Our labour costs are highest in New Delhi. We figure labour at around Rs. 8 per customer. That's nearly double what we pay in some other cities. Utilities are also high. It costs us Rs. 7,000 a month for garbage removal for the two restaurants". Is the marginal cost curve for a plate of Kabab at the Karim's Restaurant in New Delhi the same as that of the Karim's Restaurant in Kolkata ? If not how does it differ ?
- (c) Why is the price higher in New Delhi than in Kolkata ?
- (d) If marginal cost is 20 per cent higher in New Delhi than in Kolkata, and if the price elasticity of demand is 3 in New Delhi and 4 in Kolkata, what would you expect to be the percentage price differential between New Delhi and Kolkata ?

7. (a) Assume last year's real GDP was Rs. 5,000 billion, this year's nominal GDP is Rs. 6,150 billion, and the GDP deflator for this year is 130. What was the growth rate of real GDP ? Show all your calculations.

- (b) Calculate all of the missing information in the following table : 5

Year	Real GDP	Nominal GDP	GDP Deflator
1991	2,700	1,890	
2002	3,600		100
2005		4,680	130

8. Two soap companies, the Ajay company and the Bijoy company, can stress either newspapers or magazines in their forthcoming advertizing campaigns. The pay off matrix is as follows :

Possible strategies for Ajay company	Possible strategies for Bijoy company	
	Stress newspapers	Stress magazines
Stress Newspapers	Ajay's profit : Rs. 8 million Bijoy's profit : Rs. 9 million	Ajay's profit : Rs. 7 million Bijoy's Profit : Rs. 8 million
Stress magazines	Ajay's profit : Rs. 9 million Bijoy's profit : Rs. 8 million	Ajay's profit : Rs. 8 million Bijoy's profit : Rs. 7 million

- (a) Is there a dominant strategy for each firm? 4
If so, what is it?
- (b) What will be the profit of each firm? 4
- (c) Is this game an example of the prisoner's dilemma? 2

9. Based on historical data, Mr. Piramal has concluded : "The consumption of cigarettes is ... (relatively) insensitive to changes in price ... In contrast, the demand for individual brands is highly elastic in its response to price.. In 1918, for example, 555 was sold for a short time at a higher retail price than Rothmans and rapidly lost half its business." 2x5=10

- (a) Explain why the demand for a particular brand is more elastic than the demand for all cigarettes? If 555 raised its price by 1 per cent in 1918 was the price elasticity of demand for its product greater than 2?
 - (b) Do you think that the demand curve for cigarettes is the same now as it was in 1918? If not, describe in detail the factors that have shifted the demand curve, and whether each has shifted it to the left or right.
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