BUSINESS ECONOMICS

GBAT9122

SUPERVISED OPEN BOOK EXAMINATION

Time Allowed:  2 Hours
Reading Time:  10 Minutes

INSTRUCTIONS:

1. This is a supervised open book examination. Course study guide, prescribed textbook, self-made notes, pens, pencils and erasers may be brought into the examination room. Scientific and business calculators are allowed.

2. You are allowed to use electronic devices for the purpose of referring to digital course materials and notes only. These devices must not be connected to the internet, Wi-Fi must be disabled and tablets must be in flight mode. They must not be used to type your exam responses.

3. The examination paper consists of two sections:

   Section 1 (50 marks)   PROBLEM
   Answer all four questions
   Allow 55–60 minutes to complete Section 1
   Answers should be written in the exam booklets supplied.

   Section 2 (50 marks)   SHORT ESSAY/REPORT QUESTIONS
   There are two questions in Section 2. You must answer both questions.
   Allow 25–30 minutes to answer each question.
   Answers should be written in the exam booklets supplied.

4. Please note the suggested times for each section are a guide only – use your own discretion.

5. All answers must be in black or blue ink.

6. Please begin the answer to each question on a new page in the exam booklet and identify the question number you are answering when you do so.

7. Please ensure that you have written your name and other details on every exam booklet used and any other documentation submitted.

8. This exam paper must be returned with your answer books at the conclusion of the examination. No materials are to be retained at the conclusion of the exam.

9. Your reading time before the examination is 10 minutes. No writing may be undertaken during this period.

10. The exam contributes 40% towards your final grading in this course.
1. The Australian government is concerned about the health effects of smoking.
   a. Studies suggest that the price elasticity of demand for cigarettes is 0.34. If a packet of cigarettes currently costs $8, how much should the government increase price by if it wants to reduce smoking by 20%?
   b. If the increase in the price of cigarettes is permanent, will the policy be more effective in reducing smoking 1 year from now or 5 years from now? Explain your answer.
   c. Studies also suggest that teenagers have a higher price elasticity than adults. Can you explain why this maybe the case?

2. Assume you are responsible for monetary policy in Australia. Discuss and explain how each of the five possible events shown below would individually feature in any decision to adjust the cash rate. Then if all the five events occurred simultaneously, determine and explain whether you would increase, hold, or decrease the cash rate under the combined scenario? Explain in detail.
   
   Event A  Australia continues to incur a long-running drought
   Event B  There is an unexpected minerals boom driven by demand from overseas
   Event C  Australia experiences high consumer spending
   Event D  Australia experiences an increase in the number of refugees arriving by boat
   Event E  Australia’s nominal exchange rate strengthens relative to its major trading partners.

3. DC communications is the largest operator of Electronic Superstores in Australia. A new competitor ZZ Electronics is due to enter the market, and unlike the very small firms against which DC communications currently competes, ZZ is quite similar to DC and will therefore pose a serious threat to DC’s profitability.

   Over the past decade, DC has adopted the same pricing strategy. This strategy is referred to as the ‘normal’ strategy and involves prices being set at cost plus 35%. However, if a customer finds a lower advertised price at a competitors store, then DC will reduce their prices to 10% less than their competitors. When ZZ enters the market DC will have to choose between their normal strategy or an alternative ‘low price’ strategy where all prices are simply set at cost plus 20%.

   After considering ZZ’s likely moves, DC comes to the conclusion that ZZ will have to choose between the same two strategies. This enables DC to determine they will retain profits of approximately $75M (from a total market profit of $100M) if both firms undertake the normal pricing strategy. If both firms use a ‘low’ pricing strategy then the total market profit falls to $80M. If DC uses the
normal pricing strategy and ZZ uses the low pricing strategy, DC will make a profit of $55M and ZZ will make $30M, but if these pricing strategies are reversed, then even though the total market profitability is unchanged, DC profit rises to $70M.

a. Construct a payoff strategy for this game, assuming both competitors make their decision at the same time.

b. What does this analysis tell you is an appropriate pricing strategy for DC?

c. Is this a prisoner’s dilemma? Explain in detail.

4. The New Zealand government wants to ensure that dairy farmer’s incomes are high enough to sustain a traditional family. The Minister for Agriculture decides to adopt a price floor of $1 per litre. The government intends to enter the market and purchase milk until the demand and supply conditions ensure the market clearing price is $1 per litre.

The following table details the demand and supply schedules for New Zealand milk per annum.

<table>
<thead>
<tr>
<th>Price Per Litre (NZ$)</th>
<th>Demand (million ltrs)</th>
<th>Supply (million ltrs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.30</td>
<td>500</td>
<td>900</td>
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<tr>
<td>1.20</td>
<td>550</td>
<td>850</td>
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<td>1.10</td>
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<td>1.00</td>
<td>650</td>
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<td>600</td>
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<tr>
<td>0.60</td>
<td>850</td>
<td>550</td>
</tr>
</tbody>
</table>

a. Using demand and supply analysis, highlight the market clearing quantity, price and estimate the deadweight loss.

b. As a result of this action, how much surplus milk will be produced?

c. What is the cost to New Zealand taxpayers in implementing this policy?

d. The New Zealand government implements a further policy to encourage the sale of the surplus milk to primary schools at a discounted price of 60c per litre. Assume primary schools buy all the surplus stock at this reduced amount. As a result, households now reduce their normal purchases of milk at supermarkets by 50 million litres per annum because they know students are consuming milk at school. How much will New Zealand taxpayers pay out now?

e. Discuss the efficiency or otherwise of implementing this policy.

(20 marks)
SECTION 2  SHORT ESSAY QUESTIONS
ANSWER BOTH THESE QUESTIONS
(Questions are worth 25 marks each)

QUESTION 1
During the recent federal election, Prime Minister Kevin Rudd signalled a dramatic change in foreign investment policy should the Labor Party win, promising to take a tougher stance than the Opposition Leader Tony Abbott on the issue and ensure there is not an ‘open slather’ approach.
Please critique this comment.
(25 marks)

QUESTION 2
Outline the main macroeconomic policy objectives you learnt in Business Economics. Discuss the inherent problems of trying to achieve them all simultaneously. Outline the role the government can and should play in Australia.
(25 marks)

END OF EXAM