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**SCHOOL OF ACCOUNTING AND BUSINESS
BSc. (APPLIED ACCOUNTING) GENERAL / SPECIAL DEGREE
PROGRAMME**

**YEAR II SEMESTER I
END SEMESTER EXAMINATION – NOVEMBER 2014**

BEC 20125 Microeconomics

Date : 24th November 2014
Time : 9.00 a.m. - 11.30 a.m.
Duration : Two and half (02 ½) hours

Instructions to Candidates:

- This paper consists of three sections (A, B and C).
- Section A – Answer **all** the questions in the sheet provided.
Section B – Answer **four** questions out of the five questions given.
Section C – Answer **one** question out of the two questions given.
- The total marks for the paper is 100.
- The marks for each question are shown in brackets.
- Answers should be written neatly and legibly.

SECTION A

Answer all the questions.

Select the most appropriate answer.

1. Which one of the following best describes the two statements below;

Statement 01: Unemployment is typically greater in a market economy than in a centrally planned economy

Statement 02: It is good to implement taxes to reduce inequality

- a. Both statements are positive
 - b. Both statements are normative
 - c. Statement 01 is positive and statement 02 is normative
 - d. Statement 01 is normative and statement 02 is positive
 - e. Cannot be determined from the given information
2. Assume in a hypothetical economy the national income increased by 30% while the expenditure of food increased by 3%. Which of the following is true according to this information?
- a. The demand for food is price inelastic
 - b. The demand for food is price elastic
 - c. The demand for food is income inelastic
 - d. The demand for food is income elastic
 - e. The income elasticity of demand for food is negative

3. The demand and supply equations for a good are given as follows;

$$Q_d = 2200 - 200P$$

$$Q_s = -200 + 200P$$

If there is an increase in demand it will result in;

- a. An increase in both the equilibrium price and quantity
- b. An increase in the equilibrium price but not the quantity
- c. An increase in the equilibrium quantity but not the price
- d. A decrease in both the equilibrium price but not the quantity
- e. A decrease in the equilibrium price but not the quantity

4. The slope of the budget constraint is determined by the
 - a. relative price of the goods measured on the axes.
 - b. relative price of the goods measured on the axes and the consumer's income.
 - c. relative utility gained by consuming the two goods
 - d. endowment of productive resources.
 - e. preferences of the consumer.

5. Which of the following statements is true?
 - a. The average cost curve cuts the marginal cost curve when marginal cost is at its minimum
 - b. Average fixed cost is constant as output levels increase
 - c. When a firm's fixed costs are doubled the marginal costs will also be doubled.
 - d. Decreasing returns to scale are associated with an upward-sloping long-run average cost curve
 - e. Marginal cost is the change in total cost divided by the change in input

6. The statement that $\text{Marginal Cost} = \text{Marginal Revenue}$ leads to profit maximization is true
 - a. always.
 - b. only in the long run.
 - c. only if marginal cost is rising at the point of equality.
 - d. only if the marginal cost is falling at the point of equality
 - e. only if average total cost is falling at the point of equality.

7. If a firm in perfectly competitive market is experiencing super normal profits, what is likely to happen to this firm in the long run;
 - a. The price of its product will increase
 - b. The price of its product will decrease
 - c. The price of its product will remain unchanged
 - d. It will leave the industry
 - e. The firm will increase its output

8. Which of the following is not a feature of monopolistic competition?
- a. Significant barriers to entry
 - b. Presence of advertising
 - c. Many number of firms
 - d. Some control over the price
 - e. Product differentiation
9. Predatory pricing strategy means;
- a. Charging a very high price in order to attract new entrants
 - b. Charging the price which is set by the dominant firm in the industry
 - c. Charging a low price in order to drive the competitors out of the industry
 - d. Charging a competitive price assuming there are no barriers to entry
 - e. Charging the same price by all the firms in the industry
10. The element of wages that is transfer earnings will be greater, the more
- a. Elastic the demand curve of labour
 - b. Inelastic the demand curve of labour
 - c. Elastic the supply curve of labour
 - d. Inelastic the supply curve of labour
 - e. This does not depend on the elasticity of either supply or demand

(Total 10 Marks)

SECTION B

Answer only 4 questions.

Question No. 01

- a. i. Define the term 'price floor'. (02 Marks)
- ii. Identify the effects of implementing a price floor using a diagram. (04 Marks)
- b. Explain the economic rationale behind imposing high taxes on goods such as alcohol and tobacco. (04 Marks)
- c. Briefly describe three (3) determinants of price elasticity of demand. (06 Marks)
- d. Distinguish between economic rent and transfer earnings. (04 Marks)
- (Total 20 Marks)**

Question No. 02

- a. State the difference between 'Economies of scale' and 'Increasing returns to scale' (04 Marks)
- b. The production function of a firm is given as;
- $$Q = 0.04K^2L^3 + 5KL^3$$
- If the firm employs 10 units of capital find the equations for;
- i. Average product of labour
- ii. Marginal product of labour (04 Marks)
- c. According to accountants' view when total revenue equals total cost it is considered as a situation of neither profit nor loss. However in view of economists it is considered as a situation of normal profit. Comment (04 Marks)
- d. Illustrate the three stages of short run production (08 Marks)
- (Total 20 Marks)**

Question No. 03

- a. i. Define the term ‘Marginal Rate of Substitution of commodity Y for commodity X’ (MRS_{XY})

(02 Marks)

- ii. The utility function of an individual is given as;

$$U = X^2Y^3$$

Find the Marginal Rate of Substitution (MRS_{XY})

(02 Marks)

- b. ‘Indifference curves never intersect each other’ Justify this statement using a diagram

(04 Marks)

- c. Assume an individual consumes two normal goods, buns and soft drinks.

- i. Illustrate the condition that should be fulfilled in order to achieve the optimum consumption bundle

(02 Marks)

- ii. Explain how the consumer will adjust his consumption bundle if the price of soft drinks decreases using a diagram.

(02 Marks)

- iii. If soft drinks is an inferior good show how the consumer’s optimum consumption bundle will differ from the consumption bundle mentioned in ii.

(02 Marks)

- iv. Justify the reasons for your answers in (ii) and (iii) above using the income and substitution effects

(06 Marks)

(Total 20 Marks)

Question No. 04

a. Briefly explain two (2) models of oligopoly behaviour

(04 Marks)

b. 'Oligopoly markets are said to experience sticky prices'.

Comment on this statement using a diagram

(06 Marks)

c. Distinguish between dominant and dominated strategy

(04 Marks)

d. Dialog and Mobitel two oligopoly firms have to decide on their pricing strategy. The following payoff table shows their annual payoffs in terms of profits from the decisions they make.

		<i>Mobitel's price</i>	
		<i>High</i>	<i>Low</i>
Dialog's price	High	50, 25	20, 30
	Low	60, 05	30, 10

i. Is the pricing decision facing Dialog and Mobitel a prisoners' dilemma? Explain

(04 Marks)

ii. Identify the cells(s) that represent cheating in the pricing decision.

(02 Marks)

(Total 20 Marks)

Question No. 05

- a. i. State two (2) conditions required for price discrimination (02 Marks)
- ii. Describe what is meant by third degree price discrimination using diagrams (03 Marks)
- b. Distinguish between monopolistic competition and monopoly (04 Marks)
- c. Suppose the demand and total cost function of a monopolist are given as follows;
$$Q = 43 - 0.1P$$
$$TC = 25 - 10Q + Q^2$$

Find the profit maximizing output level and price (05 Marks)
- d. 'A perfectly competitive firm will earn only normal profits in the long run'.
Comment on this statement using appropriate diagrams (06 Marks)
- (Total 20 Marks)**

SECTION C

Answer only one question

Question No. 01

‘The scope of Economics is wide’

Comment on this statement by focusing on;

- Definitions of Economics
- Diverse fields of Economics and
- Importance of Economics

(Total 10 Marks)

Question No. 02

‘Are monopolies always bad?’

Critically evaluate this statement by focusing on;

- Definition of monopoly
- The pros and cons of monopolies

(Total 10 Marks)