

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

YEAR I SEMESTER I (INTAKE VI – GROUP A)
END SEMESTER EXAMINATION – AUGUST 2016

BEC 10125 Microeconomics

Date : 10th August 2016
Time : 9.00 a.m. – 11.30 a.m.
Duration : Two and a 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** questions in this section

Question No. 01

Select the most appropriate answer.

1. Which one of the following can be considered a normative economic statement?
 - a. Increasing the minimum wage results in unemployment
 - b. Higher interest rates will reduce house prices
 - c. Unemployment is more harmful than inflation
 - d. The average unemployment rate in Sri Lanka is around 4.5%
 - e. A rise in average temperatures will increase the demand for sun screen products.

2. According to a market survey the demand for sugar has a price elasticity of -1.6, whereas the supply of sugar has a price elasticity of 2.3. It can be concluded that the economic burden of an excise tax on the commodity falls;
 - a. More heavily on consumers than producers
 - b. More heavily on producers than on consumers
 - c. Equally on producers and consumers
 - d. Only on consumers
 - e. Only on producers

3. An increase in the price of crude oil, an input used to manufacture petrol, is likely to:
 - a. Decrease the demand for petrol.
 - b. Decrease the equilibrium quantity of petrol traded.
 - c. Put downward pressure on the price of petrol.
 - d. Increase the quantity of petrol demanded.
 - e. Increase the supply of petrol.

4. A monopolist will realise positive economic profits:
 - a. Always.
 - b. If total cost exceeds average revenue at the equilibrium output.
 - c. If average total cost exceeds marginal revenue at equilibrium output.
 - d. If price exceeds average total cost at equilibrium output.
 - e. If marginal revenue exceeds marginal cost at equilibrium output

5. Which one of the following does not hold in relation to long run equilibrium of a perfectly competitive market?
 - a. Falling average revenue
 - b. Constant marginal revenue
 - c. Equating price and marginal revenue
 - d. Allocative efficiency
 - e. Productive efficiency

6. Diseconomies of scale are indicated by;
 - a. The rising segment of the short-run average total cost curve.
 - b. The declining segment of the short-run average total cost curve
 - c. The rising segment of the long-run average total cost curve.
 - d. The declining segment of the long-run average total cost curve.
 - e. The rising segment of the long-run marginal cost curve.

7. The distinguishing feature of oligopolistic market structure is;
 - a. Differentiated products with heavy advertising
 - b. Mutual interdependence among firms
 - c. Significant barriers to entry and exit
 - d. Economic profit in the short run as well as in the long run
 - e. Few sellers that do not take into account rivals' reactions

8. If the consumer's income and all prices simultaneously increase by 50%, then the consumer optimum will;
- Not change
 - Shift outward relative to the old optimum.
 - Move leftward along the old budget constraint.
 - Shift inward relative to the old optimum.
 - Move rightward along the old budget constraint
9. Alpha and Beta 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>Beta</i> | | |
|--------------|---------------|---------------|---------------|---------------|
| | | <i>High</i> | <i>Medium</i> | <i>Low</i> |
| Alpha | High | 60, 40 | 55, 60 | 45, 35 |
| | Medium | 50, 30 | 70, 40 | 30, 25 |
| | Low | 35, 40 | 60, 25 | 50, 30 |

The unique nash equilibrium of the above game occurs when;

- Both A and B select high strategy
 - Both A and B select medium strategy
 - Both A and B select low strategy
 - A selects high and B selects low strategy
 - A selects low and B selects medium strategy
10. Select the correct statement in relation to monopolistic competition.
- Achieves economic efficiency in the long run
 - Zero economic profit exist in the long run
 - The firm has no control over its price
 - There are many sellers producing homogeneous products.
 - The firms have no incentive to advertise.

(Total 20 marks)

SECTION B

Answer **only three (03)** questions from this section

Question No. 02

1. Explain the concept of 'opportunity cost' using a diagram.
(04 marks)
2. Differentiate between 'consumer surplus' and 'producer surplus'.
(04 marks)
3. Briefly explain four (04) determinants of elasticity of supply.
(04 marks)
4. 'Giffen goods violate the law of demand'.
Comment on this statement.
(04 marks)
5. A consumer is able to consume the following bundles of rice and bread when the price of rice is Rs 20/= per kg and the price of a loaf of bread is Rs 30/=.

| Rice (in Kg) | Bread (No of loaves) |
|-------------------------|---------------------------------|
| 12 | 00 |
| 06 | 04 |
| 00 | 08 |

- a. Calculate the income of the consumer.
- b. Draw a budget constraint based on the given information and label it as 'B'.
- c. Draw a new budget constraint which illustrating the change if the price of rice falls Rs 10/= and label it as 'C'.
- d. Given the original prices for rice (Rs 20/=) and bread (Rs 30/=), construct a new budget constraint if this consumer's income increased to Rs 480/=. Label this as 'D'.

(04 marks)

(Total 20 marks)

Question No. 03

1. Differentiate between 'elasticity of production' and 'elasticity of cost'.
(04 marks)
 2. Identify four (04) factors that lead to economies of scale.
(04 marks)
 3. Explain the three (03) types of returns to scale using diagrams.
(06 marks)
 4. Consider a long run production function given by; $Q = KL + L$.
 - a. Find Marginal Product of Labour (MP_L) and Marginal Product of Capital (MP_K).
 - b. Explain whether the Marginal Rate of Technical Substitution (MRTS) of labour for capital is constant or diminishing as the producer substitutes labour in place of capital along an isoquant.
 - c. If the producer's total expenditure is 180 and $w = 1$ and $r = 4$ where 'w' is the price of each unit of labour input and r is the price of each unit of capital input, state the producer's isocost equation.
(06 marks)
- (Total 20 marks)**

Question No 04

1. 'It is often argued that monopoly market structure results in a welfare loss compared to perfect competition'.

Comment on this statement using a diagram.

(04 marks)

2. Differentiate between 'first degree price discrimination' and 'second degree price discrimination'.

(04 marks)

3. A firm operates under the conditions of perfect competition and its total cost function is given as; $TC = 100 + 160Q - 6Q^2$

- Identify the firm's fixed cost.
- Find the equation for the firm's average cost curve.
- Calculate the profit maximizing output level, if the price is given as Rs 16/=.

(06 marks)

4. 'A perfectly competitive firm can earn economic profits only in the short run'.

Comment on this statement using diagrams.

(06 marks)

(Total 20 marks)

Question No. 05

1. Explain two (02) reasons why prices are sticky in an oligopoly market structure.
(06 marks)
2. Explain two (02) models of Oligopoly behaviour.
(04 marks)
3. Outline four (04) features of monopolistic competition.
(04 marks)
4. In the following simultaneous game CM has three strategies and RM has four strategies. The payoffs to RM are given first in each cell of the pay-off matrix.

| | | <i>CM's Strategies</i> | | | |
|----------------------------|----------------|------------------------|---------------|-------------|--|
| | | <i>High</i> | <i>Medium</i> | <i>Low</i> | |
| RM's Strategies | Extreme | 5 3 | 4 5 | 12 4 | |
| | High | 6 7 | 5 2 | 8 6 | |
| | Medium | 4 4 | 7 6 | 14 5 | |
| | Low | 7 8 | 6 7 | 11 9 | |

- a. Identify whether any of the players have a dominant strategy.
- b. Identify whether any of the players have a dominated strategy.
- c. Find the unique Nash equilibrium.

(06 Marks)

(Total 20 marks)

SECTION C

Answer **only one (01)** question from this section

Question No. 06

‘One of the underlying principles of law of demand is the diminishing marginal utility’.

Discuss using appropriate diagrams.

(Total 20 marks)

Question No. 07

‘Monopoly is considered an undesirable type of market structure’.

Critically evaluate this statement using diagrams.

(Total 20 marks)