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

YEAR I SEMESTER I (INTAKE VI – GROUP B)

END SEMESTER EXAMINATION – JUNE 2016

BEC 10125 Microeconomics

Date	:	25th June 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** questions in the sheet provided.
  Section B – Answer only **Four (04)** questions
  Section C – Answer only **One (01)** question
- 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

Underline/ cross the **most appropriate answer** for questions 1–10.

1. An example for the opportunity cost of government expenditure on war on terrorism would be;
   a. a reduction in spending on public healthcare and education
   b. an increase in government taxes imposed on individuals and firms
   c. an increase in import expenditure on military weapons
   d. all the above

2. The price mechanism that guides actions in a market is called;
   a. the market equilibrium
   b. the invisible hand
   c. the market economy
   d. profit maximization

3. If the marginal revenue of a product is explain by $MR = 50 - 0.8Q$, the demand equation of this product would be;
   a. $Q = 50 - 0.4P$
   b. $Q = 125 - 2.5P$
   c. $P = 50 - 0.8Q$
   d. $P = 62.5 - 1.25Q$

4. The market power of a firm is explained by its;
   a. marginal revenue curve
   b. total revenue curve
   c. marginal cost curve
   d. market demand curve

5. The value the consumer gets from buying a product less its price is called;
    a. marginal utility
    b. consumer equilibrium
    c. marginal benefit
    d. consumer surplus

6. Which of the following statements does not explain price elasticity of demand?
    a. It measures the responsiveness or sensitivity of consumers to changes in the price of a good
    b. If the price change is relatively small, a point elasticity calculation is suitable
    c. Value of ‘b’ in the demand equation is equal to price elasticity of demand
    d. Arc elasticity of demand is more reliable than point elasticity in elasticity calculation

7. Three (03) stages of production in the short run are;
    a. Increasing, decreasing and negative marginal output
    b. Normal, abnormal and super-normal profit stages
    c. Increasing, constant and decreasing returns to scale
    d. None of the above

8. Optimal use of variable input is reached where;
    a. Marginal revenue equals marginal cost
    b. Marginal product equals marginal factor cost
    c. Marginal revenue product equals marginal factor cost
    d. Price equals marginal factor cost

9. Which of the following is not a characteristic of oligopoly?
    a. Few large firms produce a homogeneous or differentiated product
    b. Firms view their demand as elastic for price cuts, and inelastic for price rise
    c. Each must consider its rivals’ reactions in response to its decisions
    d. Huge capital investment may be the barriers to enter

10. When long-run average cost declines over a wide range of output relative to demand for the product, the firm experiences;
    a. Producer surplus
    b. Economic profit
    c. Economies of scale
    d. All the above

(Total 20 Marks)

Section B

Answer only **<u>Four (04)</u>** questions

<u>Question No. 01</u>

i. Explain the difference and interrelationship between positive and normative economics, using examples.

(03 Marks)

ii. "Teach a parrot the terms 'supply and demand' and you've got an economist."
Comment on the above statement.

(04 Marks)

iii. How do you use a 'production possibility curve' in economic analysis? Graphically explain.

(04 Marks)

iv. Distinguish between absolute advantage and comparative advantage using a numerical example.

(04 Marks)

(Total 15 Marks)

Question No. 02

i. What do you mean by 'constrained utility maximization'? Graphically explain this concept in favour of a rational consumer.

(04 Marks)

ii. "Any change in consumer utility depends on income effect of a price change."
Do you agree with this statement? Justify your answer.

(05 Marks)

iii. The daily budget constraint of a rational consumer is explained by;

$$Y = 10 - 0.75X$$

where, X and Y denote the amount of vegetables and meat products demanded respectively. The consumer's total daily income is Rs. 200 (assume that this consumer spends his total income on the above two products).

a. What is the price of vegetables?

b. What is the marginal rate of substitution at the consumer optimization? Justify your answer.

(06 Marks)

(Total 15 marks)

Question No. 03

i. Briefly explain the factors affecting price elasticity of demand.

(04 Marks)

ii. "When there is a decrease in supply, equilibrium price increases. As a result of this increase in price, demand decreases. This will make the equilibrium price to decrease again."
Do you agree with this statement? Explain.

(03 Marks)

iii. If a firm has estimated it's one of the products demand curve to be; $Q = 2{,}500 - 5P$,

a. What is the price and quantity demanded when the total revenue is maximized?

b. Graphically explain the above market condition.

(08 Marks)

(Total 15 marks)

Question No. 04

i. What do you mean by 'economic efficiency in production in the long run'? Explain

(03 Marks)

ii. Explain the relationship between;

a. marginal product and average product

b. marginal product and total product

(04 Marks)

iii. A manufacturing firm uses a plant with total costs; $TC = 160 + 16Q + 0.1Q^2$. The demand equation is; $Q = 240 - 2.5P$.

The firm's production manager claims that the firm's average cost of production is minimized at an output of 40 units. Further, she claims that 40 units is the firm's profit-maximizing level of output.

a. Explain whether these claims are correct.

b. What is the firm's maximum profit?

(08 Marks)

(Total 15 marks)

Question No. 05

i. If a firm is making a loss in the short run, it can select either of two actions.

a. What are those alternative actions?

b. Explain the circumstances under which, each of these actions will be taken.

(03 Marks)

ii. How do existing firms in oligopoly create entry barriers against potential entrants? Explain.

(04 Marks)

iii. A firm has estimated its daily demand and cost functions to be as follows:

$$P = 60 - 0.2Q$$

$$TC = 200 + 4Q + 1.2Q^2$$

where, Q is the quantity in units, P is the price in rupees and TC is the total cost in rupees.

a. Calculate the daily profit-maximizing price and output.

b. How much is the total daily profit?

c. If daily fixed costs rise by Rs. 200, how would this affect the firm's situation in above (a) and (b)? Explain your answer without any calculations.

(08 Marks)

(Total 15 marks)

Section C

Answer only **<u>One (01)</u>** question

<u>Question No. 01</u>

"When thinking and behaving like an economist, one has to make decisions based on opportunity cost and marginality."

Evaluate the above statement with examples related to an individual consumer and a firm.

(Total 20 marks)

<u>Question No. 02</u>

"Cooperation among the firms in oligopoly occurs without any explicit agreement or any other facilitating practices."

Evaluate the above statement by explaining the reasons for such cooperation.

(Total 20 marks)