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THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

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

YEAR I SEMESTER I (Intake V – Group A)

YEAR II SEMESTER I (Intake II/III – Group A)

END SEMESTER EXAMINATION – FEBRUARY 2016

BEC 10125 Microeconomics
BEC 20125 Microeconomics

Date	:	5th February 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

Select the most appropriate answer.

1. All of the following are prepositions of economics **except**;
   a. Everyone acts rationally by comparing the marginal cost and marginal benefit of every choice
   b. Due to scarcity choices must be made
   c. Society's wants and resources are limited
   d. Every choice has a trade-off
   e. Everyone acts in their own self interest

2. Which one of the following is a determinant of supply:
   a. The availability of substitutes
   b. The time period under consideration
   c. The prices of related products
   d. Factor mobility
   e. The width of the definition.

3. An increase in income by 3% lead to an increase in demand of a certain good by 1.2%. Based on this information the good in question is a;
   a. Normal good and income elastic
   b. Normal good and income inelastic
   c. Normal good and price elastic
   d. Normal good and price inelastic
   e. Giffen good and price inelastic

4. The utility function of an individual is given as, $U = X^3Y^2$. The marginal rate of substitution (MRS_{xy}) is
   a. 3Y/2X
   b. 2X/3Y
   c. 3X/2Y
   d. 2Y/3X
   e. 6XY

5. Elasticity of cost refers to
   a. Responsiveness of output to the changes in the variable inputs.
   b. Responsiveness of output to the changes in the total cost
   c. Responsiveness of level of inputs to the changes in the outputs
   d. Responsiveness of total cost to the changes in the level of outputs
   e. Responsiveness of total cost to the changes in the level of variable inputs

6. In which of the following stages does a rational producer operate in the short run?
   a. Stage of economies of scale
   b. Stage of constant economies of scale
   c. Stage of increasing returns
   d. Stage of diminishing returns
   e. Stage of negative returns

7. The supply curve of a perfectly competitive firm is the:
   a. Marginal cost curve above the minimum point of the average total cost curve
   b. Marginal cost curve above the minimum point of the average variable cost curve
   c. Marginal cost curve above the minimum point of the average fixed cost curve
   d. Average cost curve above its minimum point
   e. Average variable cost curve above its minimum point

8. Which one of the following is **not** a feature of monopolistic competition;
   a. Many sellers that do not take into account rivals' reactions
   b. Product differentiation where the goods that are sold aren't homogenous
   c. Multiple dimensions of competition which makes it harder to analyze a specific industry.
   d. Ease of entry of new firms in the long run because there are no significant barriers to entry
   e. Economic profit in the short run as well as in the long run

9. A market structure where the firms have an agreement among themselves on the quantity to produce and the price at which to sell the output is well represented by;
   a. Contestable market model
   b. Kinked Demand curve model.
   c. Cartel model.
   d. Monopolistically competitive market model.
   e. Perfectly competitive model

10. The situation in which each player selects the best strategy, given the strategies chosen by the other player is best known as;
    a. Nash equilibrium
    b. Dominant strategy equilibrium
    c. Dominated strategy equilibrium
    d. Mutual cooperation
    e. Rational strategy equilibrium

(Total 10 Marks)

SECTION B

Answer **only four (04)** questions from this section

Question No. 01

1. Briefly explain two (2) fundamental concepts of Economics.

(04 Marks)

2. Differentiate between 'change in demand' and 'change in quantity demanded' using diagrams.

(05 Marks)

3. Price elasticity varies along a downward sloping demand curve.
   Justify this statement using an illustration.

(05 Marks)

4. Using a diagram, illustrate the effects of implementing a price ceiling.

(06 Marks)

(Total 20 Marks)

Question No. 02

1. Briefly explain two (2) theories of consumer behaviour.

(04 Marks)

2. Compare and contrast 'inferior good' and 'Giffen good'.

(04 Marks)

3. Explain four (4) properties of indifference curves.

(06 Marks)

4. 'Irrespective of the shape, all downward sloping indifference curves exhibit diminishing marginal rate of substitution'.
   Comment on this statement by using a diagram.

(06 Marks)

(Total 20 Marks)

<u>Question No. 03</u>

1. Differentiate between diminishing marginal returns and diminishing marginal rate of technical substitution.

(04 Marks)

2. Outline the relationship between marginal product and marginal cost curves using a diagram.

(05 Marks)

3. The turning point of average total cost (ATC) curve occurs at a larger output than the turning point of average variable cost (AVC) curve. Explain using a diagram.

(05 Marks)

4. Illustrate the three (3) types of economies of scale that could be experienced by a firm in the long run.

(06 Marks)

(Total 20 Marks)

<u>Question No. 04</u>

1. 'Perfect competitive firms are often referred to as price takers'.
   Do you agree? Justify your answer.

(04 Marks)

2. State the key difference between a monopolist and a perfect competition.

(04 Marks)

3. Natural monopolies such as water and electricity are often regulated by the government.
   Discuss using a diagram.

(06 Marks)

4. The demand and total cost function of a monopolist are given as follows;

   $$Q = 80 - 0.2P$$

   $$TC = 50 - 20Q + 2Q^2$$

   a. Find the firm's fixed cost.
   b. Calculate the profit maximizing output level and price.

(06 Marks)

(Total 20 Marks)

Question No. 05

1. Briefly explain two (2) empirical measures that could be used to analyse the market structure.

(04 Marks)

2. Outline the concept of strategic interactions using an example.

(04 Marks)

3. Explain why prices often show less variation under oligopoly than under other types of market structures.

(06 Marks)

4. Two firms Alpha and Beta have to decide on their pricing strategy i.e. either to charge a high price or a low price.
   - If both firms implement a high price strategy, both will obtain a profit of Rs. 10 million each
   - If one firm implements a high price strategy and the other a low price strategy, the firm with the high price strategy will get a profit of Rs. 4 million whereas the firm with low price strategy will get only Rs. 12 million
   - If both firms implement a low price strategy, both will obtain a profit of Rs. 5 million each.

   Both firms have to decide the strategy to be implemented simultaneously and without communication.

   a. Identify the likely outcome of this pricing decision with the help of a payoff matrix.

   b. Is the pricing decision facing Alpha and Beta a prisoners' dilemma? Briefly explain.

(06 Marks)

(Total 20 Marks)

<u>SECTION C</u>

Answer **<u>only one (01)</u>** question from this section

<u>Question No. 01</u>

'Perfect competition is a more desirable market form than monopolistic competition'.
Discuss by using appropriate diagrams.

(Total 10 Marks)

<u>Question No. 02</u>

'From all the bundles of goods a consumer can purchase, he/she is assumed to select the one that results in the greatest possible level of satisfaction'.
Comment on this statement highlighting the condition required for consumer optimum with the help of a diagram.

(Total 10 Marks)