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

YEAR I SEMESTER I – INTAKE VIII (GROUP A)
END SEMESTER EXAMINATION – JULY 2017

BEC 10125 Microeconomics

Date	:	25th July 2017
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** questions in the sheet provided
  Section B- Answer only **Three (03)** 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
- Use of scientific calculator is allowed.
- Answers should be written neatly and legibly.

Section A

Answer **ALL** questions

Question No. 01

1. The cost recorded in the books of accounts are considered as;
   a. total cost
   b. marginal cost
   c. average cost
   d. explicit cost

2. Given the price, if the cost of production increases because of higher price of raw materials, the supply
   a. Decreases
   b. Increases
   c. Remains same
   d. Any of the above

3. Cross price elasticity of demand between tea and sugar is:
   a. positive
   b. zero
   c. infinity
   d. negative

4. The utility may be defined as;
   a. the desire for a commodity
   b. the usefulness of a commodity
   c. the necessity of a commodity
   d. the power of a commodity to satisfy wants

5. In a monopolistically competitive industry a firm's long run equilibrium is determined when price is:
   a. greater than average total cost (ATC) but equal to marginal cost (MC)
   b. smaller than average total cost (ATC) and greater than marginal cost (MC)
   c. equal to both average total cost (ATC) and marginal cost (MC)
   d. greater than marginal cost (MC) but equal to average total cost (ATC)

6. The price elasticity of a straight line demand curve is not constant, elasticity at the mid-point of the line would be:
   a. zero
   b. unitary
   c. infinite
   d. cannot be calculated

7. When average product is falling, it is
   a. less than the marginal product
   b. not measurable in this case
   c. greater than the marginal product
   d. equal to the marginal product

8. Monopoly and perfect competition represent
   a. the only two market structures that are identifiable
   b. the two extremes on the spectrum of market structures
   c. market structures that exist in theory only
   d. the most profitable market structures

9. In oligopoly
   a. firms compete with each other only by raising and lowering quantity because prices are fixed
   b. the fewness of firms creates mutual interdependence in pricing among the firms
   c. firms have no difficulty entering and leaving the market
   d. the firm having a natural monopoly sets price for the others

10. Product differentiation refers to
    a. different goods that have identical prices
    b. differences among goods in a market that make them close, but not perfect substitutes for each other
    c. markets that differ from industries because their goods are essentially different
    d. the firm's ability to create different goods while using the same technology and resources

(Total 20 marks)

Section B

Answer only **<u>Three (03)</u>** questions

<u>Question No. 02</u>

1. "Economics is a social science which plays a vital role in the competitive business world." Highlight the importance of studying Economics for managers in today's business environment.

   (3 marks)

2. Briefly explain the concepts of scarcity, opportunity cost and rational choices. Illustrate the relationship between these concepts using production possibility frontiers.

   (5 marks)

3. Distinguish between Free Goods and Economic Goods by giving an example for each.

   (2 marks)

4. Suppose a berry farmer is planning to grow strawberries on his land. The cost of growing strawberries is Rs.2000 per week and he earns Rs.5000 per week by selling them at the village market. There is another option for him, to grow blueberries, which could yield him Rs.5500 if he spent Rs.3500 on it.
    a. What is the opportunity cost of strawberries?

       (2 marks)

    b. Is it rational for the farmer to grow strawberries instead of blueberries? Justify your answer.

       (2 marks)

5. If the demand and supply curve for laptops are:

$$Q_D = 100 - 6P$$

$$Q_S = 28 + 3P$$

Where Q_D is the quantity demanded, Q_S is the quantity supplied and P is the price of laptops.

   a. What is the quantity of laptops bought and sold at the equilibrium?

   (2 marks)

   b. Graphically represent your answer in part 'a'.

   (2 marks)

   c. Assuming that the government makes it compulsory for all secondary students to use laptops in school, depict the relevant changes to be made to demand and supply model.

   (2 marks)

(Total 20 marks)

Question No. 03

1. Distinguish between Cardinal approach and Ordinal approach of utility.

   (4 marks)
2. State three characteristics of Indifference curves. Use diagrams to illustrate your answer.

   (3 marks)
3. Graphically illustrate and explain the conditions of consumer equilibrium under the ordinal utility approach.

   (4 marks)
4. The price of a full cream milk powder is Rs.100 and the price of a cereal packet is Rs.500.
   a. Draw the budget line for the two goods if the consumer has Rs.3000 of income.

   (2 marks)
   b. How would the budget line change if the price of a full cream milk powder rose to Rs.200?

   (2 marks)
   c. How would the budget line change if the income decreased to Rs.2000?

   (2 marks)
5. Derive the income consumption curve for a normal good.

   (3 marks)

(Total 20 marks)

Question No. 04

1. Economists categorise the periods of production in to short run, long run and very long run. Discuss the differences between these periods.

(4 marks)

2. Graphically represent the relationship between Marginal Cost and Average Cost.

(5 marks)

3. Mrs. Sirisena, the owner and manager of the Lanka Textiles is planning to keep her shop open after 4 p.m. and until 8 p.m. In order to do so, she will have to hire additional workers. She estimates that additional workers hired will generate the following total output (textile material in metres).

Workers Hired	0	1	2	3	4	5	6
Total Product	0	12	22	30	36	40	42

Suppose the price of a textile metre is Rs. 10 and wage rate per worker Rs. 40 per day, how many workers should Mrs. Sirisena hire?

(6 marks)

4. The total revenue function and the total cost function of a firm are given below. Calculate the profit maximizing output level and the profit of the firm at this output level.

$$TR = 40Q^2 + 30Q + 4650$$

$$TC = 130Q^2 + 1020$$

(5 marks)

(Total 20 marks)

Question No. 05

1. Explain how price is determined in the perfectly competitive market. Use diagrams to support your answer.

(4 marks)

2. Monopoly firms are rare in the real world. Explain the main sources of the monopoly power.

(4 marks)

3. Briefly explain the key characteristics of the monopolistically competitive market.

(4 marks)

4. Advertising strategy and product differentiation plays a key role in the monopolistically competitive market structure. Explain the reasons for this.

(4 marks)

5. Explain the concept of price discrimination and the necessary conditions for it.

(4 marks)

(Total 20 marks)

Section C

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

<u>Question No. 06</u>

Gas industry in the Euresia is controlled by two major gas suppliers. Those suppliers work closely with each other and they set relatively high prices for their gas cylinders. There is not much of a difference between the prices of the two suppliers. Government of Euresia decides to impose a maximum price of 500 Euresian Dollars, for a gas cylinder in Euresia.

Suppose that the market demand curve for Gas cylinders in Euresia is given by,

$$P = 1{,}000 - 2Q_D$$

and the market supply is given by,

$$P = 3Q_S$$

Write a report to the Minister of Energy of Euresia, explaining the economic conditions before and after this government intervention. Use graphs and calculations to support your facts, while focussing on the following areas before and after government intervention;

- Consumer and producer surplus
- Dead weight loss
- Alternative policy interventions

(Total 20 marks)

<u>Question No. 07</u>

The economist Sweezy in year 1939 stated that oligopolies face kinked demand curves. In Sweezy's model, an oligopolist believes its rivals quickly match price reductions but follow price increases only slowly and incompletely.

Elaborate on this statement using the following key areas;

- Determination of the price
- Elasticity and demand curve
- Profit Maximizing quantity

(Total 20 marks)