069

THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES PROGRAMME
LEVEL 03- 2004/2005
FINAL EXAMINATION 2005
MICRO ECONOMICS –MCU 1205
DURATION: THREE (03) HOURS

DATE: 25.02.2006 **TIME: 9.30 a.m. - 12.30 p.m.**

INSTRUCTIONS: ANSWER ANY FOUR (04) QUESTIONS.

(1) The demand and supply of product X, are given as,

$$Q_d = 60 - 4p_x \qquad Q_s = -20 + 6p_x$$

(i) Find the equilibrium price and quantity.

(ii) Explain the market out come when:

a. price of inputs increases
b. price of substitutes increases, using graphs

(iii) Suppose that the number of sellers increases and supply changes by 5, find the new equilibrium price and quantity?

(iv) Suppose that the government introduces a legal price at 6/=, what will be the economic consequence of this decision?

(v) If the government imposes;

(a) Rs. 2/= tax on each unit sold
(b) Rs. 2/= subsidy on each unit produced,

Find new market equilibrium condition in each situation
(For all steps consider the initial demand and supply equations)

(25 Marks)

(2) (a) What are the determinants of price elasticity of demand?

(b) Considering the information given in relation to goods x and y, explain how the firm can increase the revenue from the given two goods, manipulating the price.

Good x	Good y
* No close substitutes	Large number of substitutes available
* A necessary good	A luxury good
* High consumer loyalty	Has to spend large percentage of your income

(c) Using the details in the table find income elasticity of demand using both point and arc calculation methods?

Income	Quantity x	Quantity y
Rs. 20,000/=	60	20
Rs. 24,000/=	80	22

Comment on value of elasticity(s) ?

(25 Marks)

(3) (a) Explain why,

(i) Indifference curve cannot have a positive slope.
(ii) Indifference curve cannot cross each other

(b) If the price of two goods x and y are P_x *and* P_y respectively and consumer income is R, prove that at the consumer equilibrium,

$$MRS_{xy} = \frac{MU_x}{MU_y} = \frac{P_x}{P_y}$$

(c) Comment on the shape of the price consumption curve for,

(i) tea and coffee
(ii) tea and sugar

When price of tea comes down, while the price of the other and the income remains the same.

(25 Marks)

(4) (a) How would the perfectly competitive firm determine the optimum level of out put according to marginal and total approach?

(b) Explain how the perfectly competitive firms achieve the equilibrium in long run and comment on its efficiency.

(25 Marks)

(5) (i) What factors can create a monopoly?
(ii) Explain how the monopolist achieve the equilibrium in the long run.
(iii) How does the total revenue of a monopolist change according to the elasticity of its demand curve?

(25 Marks)

(6) (a) What is the rational behind "U" Shape of the short run and long run average cost curves?
(b) Why would the gap between average total cost curve and average variable cost curves reduce as the out put increase?
(c) The total cost function is given as:

$$TC = 1200 + 8Q - 8Q^2 + Q^3$$

(i) Is this long or short run cost function? Give reasons.
(ii) Find average fixed cost when level of out put is 10.
(ii) Find Total Variable Cost (T.V.C), Average Variable Cost (A.V.C.) and Marginal Cost (M.C.)
(iii) Find the out put at which A.V.C. is the lowest

(25 Marks)

(7) Write brief notes on the following;

(a) Explicit and Implicit cost
(b) Out put elasticity of labour
(c) Diminishing Marginal Rate of Substitution.
(d) Dominant price leadership
(e) Kinked Demand Curve

(25 Marks)