

THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES
LEVEL (03)



MCU 1205 – MICRO ECONOMICS

ASSIGNMENT TEST – 2007

DURATION: TWO (02) HOURS

Date: 25th August 2007

Time: 10.00 a.m -12.00 noon

Answer any three (03) questions
All questions carry equal marks
Use of non programmable calculators are allowed

1. a) What is the difference between “Demand” and “Effective Demand”?
b) The demand and supply functions of an agricultural product is given as;
- $$Q_d = 48 - 3P$$
- $$Q_s = -16 + 5p$$
- (Price in Rs. & quantity in 000 kg's)
- I) Find the equilibrium price and quantity .
II) Suppose the government introduces a legal price at Rs. 6 /=, what will be the economic consequence of this decision?
III) If government grants a subsidy of Re. 1/= for every kg. that is being produced, what is the new equilibrium price and quantity?
IV) Suppose that there is a technological improvement in the given sector and the supply changes by 4 units, what is the new equilibrium price and output?
V) Using illustrations explain how the favorable and unfavorable weather conditions affect the market outcome.

(Note: For every step consider the initial demand and supply functions)

2. a) Comment on the Price Elasticity of Demand of the following,
- I. Fuel
 - II. Colour televisions
 - III Rice
 - IV Motor vehicles
- b) “The firms can increase its total revenue by manipulating the price, according to the elasticities of the products they sell”. Discuss with illustrations.

c) The income quantity relationship of goods X and Y are given as follows.

Income	Quantity Demanded	
	Good X	Good Y
Rs.28,000/=	120	8
Rs.36,000/=	140	12

- i) Calculate Point and Arc income elasticity of demand for both goods.
 - ii) Comment on the elasticities of both goods.
 - iii) Can we consider X to be a luxury good and Y to be a necessary good? Give reasons .
- 3)
- a) What is the law of Equi- Marginal Utility?
 - b) Explain why the indifference curves, cannot intersect each other?
 - c) Prove that the slope of the indifference curve is equivalent to the ratio of the marginal utilities of the two goods. (Consider two goods as X and Y)
 - d) “Although the income effect of an inferior good is negative, the total price effect is positive” Do you agree? Explain.
- 4)
- a) Suppose the firm is not in a position to change the amount of capital. The management has decided to increase the quantity of labour to increase the production. As a person with knowledge of economics, explain how the total, marginal and average product of labour change when the increasing quantities of labour is added to fixed capital.
Use illustrations to explain your answer.
 - b) Explain how the firm can calculate “Business” and “Economic” profit?
 - c) Can a firm continue to produce when the price of the product is bellow its Average Variable Cost (AVC) of production? Give reasons.