THE OPEN UNIVERSIT OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES PROGRAMME
LEVEL 03
FINAL EXAMINATION-2008
MICRO ECONIMICS-MCU 1205

DURATION: THREE (03) HOURS

DATE: 23-02-2008	TIME: 9.30 am to 12.30 noon

INSTRUCTIONS

- **Answer any five (05) questions**
- **All questions carry equal marks.**

(1) (a) Using demand and supply analysis, explain the market out come of the following. Use illustrations.

i. Price of shoes increases, market for socks.
ii. Price of bread increases market for rice.
iii. Government provides a subsidy for rice farmers, market for rice.
iv. Government imposes a tax on liquor, market for liquor.
v. A new report has been released on the harmful effects of cholesterol, market for eggs. (2 marks x 5 =10)

(b) The demand and supply functions of good x, given as,

$Q_d = 48 - 4p$ $\qquad$ $Q_5 = -16 + 4p$

(Quantity in 1000 units and price in Rs.)

For every step use the initial demand and supply functions
Use illustrations to explain your answer.

(i) Find the equilibrium price and quantity. (2 marks)
(ii) Suppose people expect the price of "x" to rise in the future and present demand changes by 4 units. What is the new market condition? (4 marks)
(iii) If government introduces a legal price at Rs.7/=, what will be the economic consequences of this decision? (4 marks)

(2) (a) i)Consider the following facts in relation to goods "x" & "y" and determine the elasticity of demand of each.

Good x	**Good y**
A necessary good	A luxury good
High consumer loyalty.	Large percentage of income has to be spent
No close substitutes	Many substitutes

(2 marks)

ii) If the firm is to increase the revenue from both goods, how can the price of the given good be manipulated? (4 marks)
iii) Suppose government imposes a tax on the supply of each product, how will the tax be shared between the consumer and supplier? (6 marks)

(b) i) Consider the following information and explain the relationship between the goods. Provide examples.

	Cross price elasticity
goods x and A	(+)
goods x and B	(-)
goods x and C	(0)

(5 marks)

ii) Comment on the cross price elasticity of Pepsi and Coke.(3 marks)

(3) (a) How will the consumer maximize satisfaction according to

i) Cardinal utility

ii) Ordinal utility analysis (5 marks)

(b) i) Define Income effect and Substitution effect. (3 marks)

ii) Highlight the difference among Normal, Inferior, Giffen goods using Indifference Curve analysis. (12 marks)

(4) (a) i) Distinguish between Short Run and Long Run production(4 marks)

ii) "In Short Run, rational producer should maintain the level of production within the second stage, i.e the stage of diminishing returns'. Explain using illustrations. (10 marks)

(b) Prove that the firm achieves the optimum level of production when,

$$MRTS_{LK} = \frac{P_L}{P_K}$$

L – Labour K - Capital P – Price

MRTS – Marginal Rate of Technical substitution (6 marks)

(5) (a) Explain how the Monopoly decides profit maximizing output and price using Marginal analysis. (5 marks)

(b) "Compared to Perfect Competition, Monopoly results in less efficient allocation of resources" Do you agree? Explain using illustrations. (15 marks)

(6) (a) "Product differentiation is the hallmark of Monopolistically Competitive Market". Discuss with examples. (10 marks)

(b) "Theoretically markets are categorized as Perfectly Competitive and Monopolistically Competitive, yet Monopolistically Competitive markets are more realistic" Discuss with examples. (10 marks)

(7) (a) What is Collusive Price Leadership? (4 marks)

(b) Suppose there are four firms in a market. One firm decides to increase the price, how will this affect its market share when,

i) other firms also raise the price.

ii) other firms do not raise the price?

Use illustrations. (8 marks)

(c) Using the Kinked Demand Curve Analysis explain why there is price, quantity stability in Oligopolistic markets. (8 marks)