THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES PROGRAMME
LEVEL 03
FINAL EXAMINATION 2009
MCU 1205 – MICRO ECONOMICS
DURATION : THREE (03) HOURS

DATE: 14$^{TH}$ MARCH 2009          TIME: 9.30 A.M. – 12.30 P.M.

**Answer any five (05) questions. All questions carry equal marks**
**Use of non programmable calculators allowed**

(1) (a) What is the impact of the following given situations on the market conditions. Use illustrations to explain your answer.
    (i) Imposing a tax of 't' on the supply of electrical goods.
    (ii) Providing a subsidy on production of rice.
    (iii) Imposing a maximum legal price on a kilo Gram of rice.
    (iv) Introducing a minimum legal wage.                    (10 marks)

(b) Demand and supply functions of good 'x' is given as;
$$Q_d = 36 - 3p \qquad\qquad Q_s = -14 + 7p$$
Price in rupees and quantity in 1000 units
    (i) Find equilibrium price and quantity.                    (02 Marks)
    (ii) Suppose price of inputs needed to produce good X declines and the supply changes by 5 units. Find the new equilibrium condition.                    (03 Marks)

    (iii) Suppose the government introduces a price floor at Rs. 7/=. What will be the economic consequence of this?
How much will this cost the tax payers?                    (04 Marks)

    (iv) Suppose there are 1000 identical suppliers and 10,000 identical consumers in the market. Find the market demand & Supply functions.                    (01 Mark)
(For every step consider the initial demand and supply functions).

(2) (a) Explain with examples how the price elasticity of demand is useful in business decision making.                    (06 Marks)
(b) How is the tax shared between consumers and suppliers, when a tax is imposed on supply of a good that has;
    (i) Inelastic demand
    (ii) Elastic demand
Explain with illustrations.                    (06 Marks)
(c) Total and Marginal revenues of a Monopolist are related to the elasticity along the demand curve it faces. Explain using an illustration the relationship between the firm's revenue and the elasticity of its demand curve.
In what range should the Monopolist maintain its out put?                    (08 Marks)

(3)   (a)   Prove the following
        (i)    Indifference curves cannot intersect each other.
        (ii)   The slope of the indifference curve is equivalent to the ratio of the marginal utilities of the two goods in the combination. (Consider two goods as X and Y).     (08 Marks)

    (b)   Total utility of goods X and Y are given as follows.

| | $Tu_x$ | $Tu_y$ |
|---|---|---|
| 1) | 42 | 66 |
| 2) | 80 | 126 |
| 3) | 114 | 180 |
| 4) | 144 | 228 |
| 5) | 170 | 270 |
| 6) | 192 | 306 |
| 7) | 210 | 336 |

        (i)    Suppose price of X is given as Rs.2/= and price Y as Rs.6/=. If person's income is Rs. 32/=, Find the quantities that maximize consumer satisfaction.     (06 Marks)
        (ii)   Suppose price of X increases to 3/= and price of Y remains the same. Find the consumer equilibrium if the person's income increases to Rs. 57/=.     (06 Marks)

(4)   (a)   (i)    Define the short and long run production function.    (03 Marks)
        (ii)   Comment on the short and long run production of following industries.
            (i)    Catering
            (ii)   Oil     (05 Marks)
    (b)   What is meant by Out Put Elasticity of Labour?     (04 Marks)
    (c)   Using illustrations explain the relationship between the Law of Diminishing Marginal Returns and three stages of production.(08 Marks)

(5)   (a)   Cost figures of a hypothetical firm are given in the table below. Fill in the table.

| Output | Total Fixed Cost | Average Fixed Cost | Total Variable Cost | Average Variable Cost | Total Cost | Average Total Cost | Marginal Cost |
|---|---|---|---|---|---|---|---|
| 1 | 120 | | 20 | | | | |
| 2 | | | 36 | | | | |
| 3 | | | 48 | | | | |
| 4 | | | 80 | | | | |
| 5 | | | 120 | | | | |
| 6 | | | | | | | 72 |

                                  (10 Marks)

    (b)   "Although the short and long run Average Cost curves have U shape, the reasons for this are quite different" Do you agree? Explain.   (10 Marks)

(6)    (a)    Compare and contrast the Perfectly Competitive and Monopolistically Competitive markets.      (06 marks)

        (b)    "Compared to Perfectly Competitive markets, Monopolistically Competitive markets are less efficient in the long run" Do you agree? Explain with illustrations.      (14 marks)

(7)    (a)    Suppose a firm in an Oligopolistic market decides to increase the price of its product. Using illustrations explain the market outcome when,
            (i)      its rivals do not follow the given firm
            (ii)     its rivals too, increase the price.      (06 Marls)

        (b)    "Oligopoly is a market structure in which a few large firms produce identical or slightly different products and entry is difficult but not impossible" Discuss with examples.      (14 Marks)

*-Rights Reserved-*