

Mid term exam

Literature, Russian Literature



1. a. Opportunity cost is the cost of the foregone alternative. It is the cost incurred for not selecting a particular course of action. Opportunity cost is present in a lot of areas in economics, such as labor and capital.

b. Increasing costs are expenditure that rises due to a particular activity. For instance, if the economy is growing and the disposable income of the population is increasing, the velocity of circulation of money will rise. This will eventually lead to increasing costs.

c. Unemployment basically comprises the part of labor, which is capable of working, but which presently is not employed. Unemployment arises when the actual output of the economy is lower than the potential gross national product.

d. Scarcity arises whenever the quantity supplied does not meet the quantity demanded for a product or service. Scarcity can also apply for labor supply, in instances, where the economy is growing at a fast rate, but there is not sufficient labor to accommodate the job vacancies needed.

2. a. Chicken is a substitute product of beef. Therefore the rise in price of chicken will lead to a rise in the demand of beef leading to an outward shift of the quantity demanded.

b. If the wages of meat cutters will increase, more individuals would be interested in working in that area. Therefore the quantity supplied of meat would increase leading to an outward shift in the quantity supplied.

c. As income increases the disposable income of the population will rise. If meat is considered a luxury good, the quantity demanded will rise because

more will be afforded. As a result an outward shift in quantity demanded will arise.

d. If import quotas are eliminated, the competition and supply of beef will increase. This will lead to a surplus in the market, which will eventually direct to a lower demand. An inward shift of the quantity demanded will thus arise.

3. If for instance, the availability of cows diminishes due to an epidemic disease on cows. This will direct to a leftward shift in the quantity supplied resulting in the quantity supplied not meeting the quantity demanded. This shortage of meet, will eventually lead to a shift in the demand curve to reach again equilibrium position at a higher price. The level of employment will be enhanced due to more number of firms willing to enter the market. However, such shortage may limit the availability of meet supply.

On the contrary if competition is increased in the market of beef, due to a reduction/removal in import quotas or new entry of firms, the quantity demanded will shrink through an inward shift. This will thus lead to a quantity supplied greater than quantity demanded. Therefore there will be a surplus of meet supplied that will direct a shift in the quantity supplied to meet again equilibrium at a lower price. Firms will eventually drop out of the market due to lower profits leading to a decrease in the level of employment in such industry.

4. The total utility of a client is maximized when the marginal utility of a commodity is equal to the marginal utility of the other good. Indeed the indifference curve is a graph that portrays a combination of commodities

with the same level of utility. Points are inputted from the situation at hand, which are eventually connected to form an indifference curve graph. This holds on the assumption that consumption of goods is varied continuously and not incrementally.

5. a. Price elasticity of demand is a measure of the level of responsiveness of the quantity demanded to changes in price. Price elasticity of demand is not the demand curve.

b. The income of an individual is an important determinant of demand. Income elasticity of demand is a calculation that shows the sensitivity of demand in relation to changes in income.

c. In the real world a manager should not isolate on the price of the product or service sold only, he should also consider the prices of substitute and complementary products and services. In this respect cross-price elasticity of demand is used to calculate the responsiveness of demand of the product marketed in relation to changes in prices of substitute or complementary products.

d. Price elasticity of supply also is a determination of the level of responsiveness of the quantity supplied to movements in price.

6. The price elasticity of demand is the effect that a change in a variable will hold on the other variable. A coefficient price elasticity of demand equal to 1 is attained for a unitary elasticity, one greater than 1 for an elastic demand and one less than 1 for an inelastic demand. Under unitary elasticity, a percentage change in price will exactly provide the same effect on the

quantity demanded. Therefore a one percent increase in price will lead to a one percent decrease in quantity demanded.

An elastic demand is an instance where a change in price leads to a more than proportionate effect on quantity demanded. Thus a one percent increase in price will lead to a decrease in demand greater than one percent. On the contrary, under inelastic demand a change in price will lead to a less than proportionate change in quantity demanded. So a one percent increase in price will direct to a less than one percent decrease in quantity demanded.

7. Under an elastic demand total revenue would decrease when the price rises. This is due to the fact that the increase in price will be exceeded by the reduction in units demanded due such elasticity. For instance a product that holds a price elasticity of demand of 5. If the present demand is 100 units and the actual price is \$5, the total revenue is \$500.

If a 1% rise in price occurs increasing it to \$5.05 a fall of 5% in demand will occur direct sales to 95 units. In this case the total revenue would amount to \$479.75, which is lower than the original revenue. On the contrary, under an inelastic demand a rise in price will direct to higher revenue since the percentage decrease in units sold would be less than the percentage increase in price.

8. The cross-price elasticity of demand for substitute goods is always positive because the price of one item and the demand of the other move always in the same direction. For example, chicken and meat are substitute goods. If

the price of chicken will rise, the quantity demanded for meat will increase too, because clients will shift from buying chicken to meat.

The cross-price elasticity of demand for complimentary goods, on the other hand, is always negative because the price and quantity demanded of the variables at hand move at the opposite direction. For instance, cameras and films are complimentary. If the price of films increase, the demand for cameras will fall because fewer customers will purchase cameras in light of additional costs incurred for films, which are necessary for the camera to take photos.

9. The first and most important is the availability of substitutes. The more a product or service faces substitute products, the more price-elastic is the demand. This is due to the fact that if there are close substitutes and the price of the product is increased, the customer will shift to the substitute product and therefore the demand for the commodity will decrease. For example, if the price of laptop computers were to rise, the demand for such product will probably fall because people will shift to personal computers.

It is important to note that the effect of substitutes highly depends on how ‘ substitute products’ are defined. Usually the more specific the definition the higher the number of substitute products. For instance, if the example of laptop computers were to be lessened to laptop computers of Hewlett Packard, one would find more substitute products like laptop computers of other competing companies, leading to a greater price-elastic demand.

The income spent on the product is another determinant of price elasticity of demand. The higher the income spent on the commodity, the more elastic is

the demand. For example, goods like bread, pepper, and sugar tend to have an inelastic demand curve, because they make up a low amount of the consumer's budget.

While products like cars have a more elastic demand curve due to the fact that people are more cost conscious when products are of a high value and therefore are more affected by changes in price. However, in practice it is not guaranteed that the hypothesis mentioned in this paragraph actually takes place. Indeed, some economists weaken the theoretical relationship that exists between the proportion of income spent on the product and the price elasticity of demand.

Time element also places significant influence on price elasticity of demand. The longer the time period, the more price-elastic is the demand, because substitute goods will be adapted or created to cater for the change in price. For example, if the price of electricity were to increase drastically during the passage of time people will replace their home equipment and appliances to consume less electricity.

For instance they may adopt a solar geezer or replace their electric cooker with a gas cooker. On the contrary, the price elasticity of demand of durable goods behaves in the opposite direction. For durable goods like cars, the responsiveness of demand to price movements weakens with the passage of time. This is primarily due that in the long run old cars wear out and clients are forced to replace such vehicles if they intend to remain in the same product category.

10. Returns to scale are a production technique that considers how a proportionate increase in factors of production will affect total production output. There are three stages of return to scale, being constant, increasing and decreasing. Management should reach the highest point of the increasing returns to scale, where output rises in a higher proportion than input. Economies of scale are more a cost concept, which examines the effect of production on costs through labor specialization and other technical factors. The information portrayed below show the costs of production for a particular product.

As we can see the higher number of units produced per worker is at 4 employees. After that a diminishing return to scale will arise. This coincides to the attainment of economies of scale, where the additional cost per new employee is at its lowest by \$1. In this respect returns to scale and economies of scale are related in the sense they normally correspond with each other. Indeed, economies of scale normally aid the organization in attaining increasing returns to scale.

11. Short-run is considered as any time frame in which there is at least one factor of production that cannot be altered and is considered to be fixed. In the long run all factors of production are variable and can be altered. In order to remain operative in the short run a firm ought to cover all the variable costs. Fixed costs at this stage are considered as sunk costs because they cannot be altered and will not affect the going concern decision.

12. Explicit costs are costs that involve a cash outflow of money, while implicit costs are expenditure that does not involve cash payments, such as depreciation.

13. The economic concept of profit is based on theoretical constructs. Originally such concept focused on the difference between revenue and expenditure, being the surplus needed to maintain the capital of the firm. The economic cost of production for a firm was regarded as the opportunity cost of production.

With respect to the accounting concept of profit, one must consider the fact that originally the accounting concept of profit was similar to nowadays-economic concept of profit. Indeed at the origination of this concept accountants regarded profit from a balance sheet perspective. However during the passage of time accounting profit shifted to a matching of revenues and costs consumed in a particular period of time. Accountants contend that such shift developed through the evolution of business enterprises, from a fully liquid business enterprise to large public limited companies.

14. a. A firm made Sales revenue of \$10, 000 and revenue expenditure amounted to \$9, 000. Equipment of \$10, 000 was bought and the present interest rate is 10%. The accounting profit is \$1, 000, while there is no economic profit since an opportunity cost of capital of \$1, 000 is deducted with respect to the foregone money due to the equipment bought.

b. A firm made Sales revenue of \$12, 000 and revenue expenditure amounted to \$8, 000. Equipment of \$12, 000 was bought and the present

interest rate is 10%. The accounting profit is \$4, 000, while the economic profit is \$2, 800.

c. A firm made Sales revenue of \$9, 000 and revenue expenditure amounted to \$7, 500. Equipment of \$20, 000 was bought and the present interest rate is 10%. The accounting profit is \$1, 500, while the economic loss amounts to \$500.

d. As regards example b, the company is attaining economic rent and will thus continue operating. Under perfect competition new firms will enter this market in the long term. In case c, the firm will get out of the market due to an economic loss. As regards example a, a normal profit is attaining, implying that the market is at an equilibrium and under perfect competition no firms will enter or exit the market.

References:

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