Short answers

Literature, Russian Literature

Question 3 If a tax is placed on the seller of a good, then it depends that whether the seller will bear the complete tax burden or whether he will pass the whole or partial of the tax burden to the consumer. If the product's demand is highly elastic then a small increase in price will bring a sharp decrease in the quantity demanded of a product. So under such situation the seller will bear the entire tax burden and the customer will remain unaffected. Similarly if a product's demand is highly inelastic, then an increase in price will have negligible affect on quantity demand. So under such situation the seller will pass the entire tax burden on the consumer and will remain unaffected himself.

Question 5

If the price elasticity of demand (PED) of a product is 0. 75, then it means that the product has an inelastic demand. This means a percentage change in price is not followed by a significant change in quantity demanded. If the firm decides to increase the price by 20 % then quantity demand will be negligibly affected and the total revenue will increase.

PED= % change in quantity demanded / percentage change in price

0. 75 = X / 20 %

% change in QD = 0. 15 %

Thus if the firm increases its price by 20 % the QD will only fall by 0. 15 %. Total revenue increases if either price increases or QD increases. Here price is increasing by a greater proportion then the decrease in QD, therefore the overall total revenue for the firm will also increase.

Question 6

The consumer equilibrium in case of two goods is determined by the following:

Marginal utility of Beer / Price of Beer = marginal utility of Pretzels / Price of Pretzels.

100 / 5 = 20 / 1

The consumer has purchased the correct amount of each good as the marginal utility per dollar spent on the beer is exactly equal to the marginal utility per dollar spent on pretzels.

However of the price of beer falls to $ 4 and the price of pretzels fall to $ 0. 5 then:

100 / 4 < 20 / 0. 5

25 < 40

The above shows that after the price change, the marginal utility per dollar spent on pretzels is higher than the marginal utility per dollar spent on beer. Under such circumstances the consumer should spend more on pretzels and less on beer. He should continue to do so until the marginal utility per dollar spent on both the goods become equal.

Question 7

If by hiring additional labor the total output increases with the decreasing rate, then the labor can said to have diminishing returns e. g if a firm hires 4th unit of labor, then the total output increases by 10 units. However when the firm hires 5th unit of labor, then the total output increases by 8 units only. So under such situation the total output is increasing but with a decreasing rate, this is known as diminishing returns. Similarly if a firm currently has 4 labors and they were producing 300 units per day. Now if the firm hires 5th unit of labor, but they manage to produce only 270 units per day, then this is known as negative returns, as the total output decreases with additional labor.

Question 8

Under a perfectly competitive market there are a large number of small firms, such that the size of the individual firm is very small as compared to the over all size of the market.

The contribution of an individual firm to the total market's output is very small so if an individual firm alters its production plans, the market remains unaffected.

The good produced under perfect competition are homogenous i. e goods of an individual firm is exactly identical to the goods of the other firm, they are perfect substitutes. So if an individual firm tries to charge a higher price on the basis of product differentiation, then the buyers can easily switch over to other sellers.

Under perfect competition buyers have perfect knowledge of the market, they have complete knowledge related to the products quality and price, so none of the seller can fool consumer on the basis of price differentiation.

Firms under perfect competition faces a perfectly elastic demand curve (horizontal demand curve), because they are price takers. They can only increase their profits by selling more and more on the prevailing market price. If a firm tries to charge a higher price then nobody will buy from it as buyers have perfect knowledge of the market. Similarly if a firm tries to sell more output at a price which is lesser then the prevailing market price then it won't be able to attract all the market customers and therefore will be at a loss.

Question 9

A monopolist is known as a price searcher because it always searches for a profit maximizing price in order to sell its output. It does that by comparing the MR and the MC of each price and output combination on the demand curve.

Since the monopolist faces a downward sloping demand curve so it can either control the market price of the quantity supplied, but not the both. If it wants to sell more output then it needs to lower the market price and vice versa. Thus this way a monopolist MR always fall if it increases its output this also means that the MR that a monopolist gets from producing an extra unit of output is always less then the price that it charges for that unit.

E, g if a monopolist produces 10 units at $ 10 each then its total revenue will be $ 100. However if it produces 11 units, he will now sell it at $ 9 each, so now his total revenue will be $ 99. Therefore his MR will be $ 1, which is less then the price, $ 9, that he had charged for the last unit.

Question 10

In the short run if exiting firms under perfect competition are making super normal profits, then new firms are attracted by these profits and they enter the market. When new firms enter the market, they supply their individual outputs in the market. This causes the market supply to increase, causing the market price to fall. New firms continue to enter until all the positive profits are eroded away and all the existing firms end up earning normal profits only.

Similarly, if all existing firms under perfect competition are suffering from losses then existing firms will start leaving the industry as they don’t have any incentive to remain in the market. When exiting firms start leaving then market supply start decreasing causing the market price to rise. Exiting firms will continue to do so until all losses turn in to normal profits.

Question 13

There are numerous barriers which restricts the entry of new firms in to an industry.

If the entry in the market requires large investment, for instance large investment in capital equipment of if the fixed cost are too high to start a business, then new firms are naturally restricted to enter the market.

If existing firms in a market are enjoying the economies of scale then it automatically hinders the entrance of new firms in the market. This is because existing firms have undertaken large scale production because of which their unit cost is very low and they charge low prices from consumers. New firms can never enter the market and compete at such low prices as they have not yet taken large scale production, so their unit cost I high.

Government policies can also prevent new firms from entering the market for instance through especial license requirement, environment protection regulation etc hinders the entry of new firms into the market.

Question 1

The above diagram shows the PPF that has increasing opportunity cost. By this we mean that in order to produce an additional unit of Good X, more units of Good Y will have to be sacrificed. This I because resources that were previously employed in the production of Good Y, tends to be inefficient when we move them towards the production of Good X, as they were more appropriate for the production of Good Y and less appropriate for the production of Good X.

Question 2

The above diagram shows an increase in demand from Do to D1 due to an increase in the advertisement of a particular good. If a product advertisement increases then people get more awareness and they are more attracted towards the product. So due to an increase in the advertisement, more is demanded at the same market price.

However an increase in advertisement does not affect the supply of the product because advertisement has no affect on the production of a product, so the salesmen's statement is in accurate. Advertisement is not a factor that affects supply but is rather affects the quantity supply.

Question 4

A binding price ceiling is one which is set below the market equilibrium price. The above diagram shows the effect of binding price ceiling the equilibrium market price and quantity are PE and QE respectively. However the government sets the price ceiling at P1 which is below the equilibrium market price. This causes the market supply to decrease from QE to QS. This is because suppliers are not willing to supply their product at this low price. However QD has increased from QE to QD because buyers are willing to buy more at this low market price. Thus QD is greater then QS because of which a shortage of good occurs in the market. Now if government does not take proper measures to deal with this shortage, then market can face problems of black marketing, discrimination etc.