



MACHAKOS UNIVERSITY

University Examinations for 2016/2017

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF ECONOMICS

SECOND YEAR SEMESTER SPECIAL EXAMINATIONS FOR DEGREE IN

BACHELOR OF ECONOMICS AND FINANCE,

BACHELOR OF ECONOMICS & STATISTICS

BACHELOR OF ECONOMICS,

EET 200: MICROECONOMIC THEORY II

DATE:

TIME:

INSTRUCTIONS TO CANDIDATES

Answer Question **ONE** and any other **TWO** questions

QUESTION ONE (30 MARKS)

- a) Discuss the conditions under which a perfect competitive firm operates (5 marks)
- b) Explain why indifference curves cannot intersect (3 marks)
- c) With the aid of diagrams differentiate between perfect substitutes and perfect complements. (4 marks)
- d) What is meant by the following terms as used in economics, with the aid of a diagram:
 - i. Opportunity cost
 - ii. Isoquant
 - iii. Consumer Rationality (6 marks)
- e) Consider a monopolist facing an average revenue function given by $P=280-4Q$. In addition, his total cost is given by $TC=20+10Q^2$. Find:
 - i) His profit maximization output level (Q^*) and the maximum profit (π^*). (5 marks)
 - ii) Indicate clearly his first and second order conditions for profit maximization (4 marks)
 - iii) From your solution above, calculate the monopolist's sales maximization quantity, price and the maximum revenue (3 marks)

QUESTION TWO (20 MARKS)

- a) What is meant by price discrimination by a monopolist? (2 marks)
- b) Discuss three conditions that favour effective use of price discrimination (6 marks)
- c) Under perfect competition market structure, and short run equilibrium, use well labelled illustrations to demonstrate a firm making;
 - i) Super normal profits (4 marks)
 - ii) Losses (4 marks)
 - iii) Zero economic profit (4 marks)

QUESTION THREE (20 MARKS)

- a) Differentiate between normal good, inferior good and a giffen good (6 marks)
- b) Assume a consumer spends all his income in the purchase of two goods X and Y whose prices are Sh30 and Sh20 per unit respectively. The consumer's monthly income is Sh12,000. He is satisfied with the various combinations of X and Y but prefers to spend his income in equal proportions on the commodities, that is, at a ratio of 1:1 to maintain his level of satisfaction:
 - I. Using clearly labelled diagrams:
 - i) Show the relevant budget line and indifference curves indicating the equilibrium position of the consumer (3 marks)
 - ii) What is the effect of an increase in the consumer's income from Sh12,000 to Sh24,000 per month (3 marks)
 - II. Suppose X is a normal good, illustrate graphically the substitution and income effects on a fall in the price of good X (8 marks)

QUESTION FOUR (20 MARKS)

- a) Explain the concept of Pareto optimality and derive the condition for Pareto efficient allocation assuming two goods (5 marks)
- b) State the law of variable proportions and outline its key assumptions (6 marks)
- c) Using well labelled diagram(s), illustrate the relationship between Total Product (TP), Marginal Product (MP), and Average Product (AP). Indicate economic and efficient zones respectively (9 marks)

QUESTION FIVE (20 MARKS)

- a) Why firm's short-run and long-run costs are curves U-shaped? (4 marks)
- b) With the help of a well labelled diagram explain the relationship between average fixed cost, average variable cost, average total cost and marginal cost curves. (8 marks)
- c) Explain what economies and diseconomies of scale are. Give examples of both of these (8 marks)