

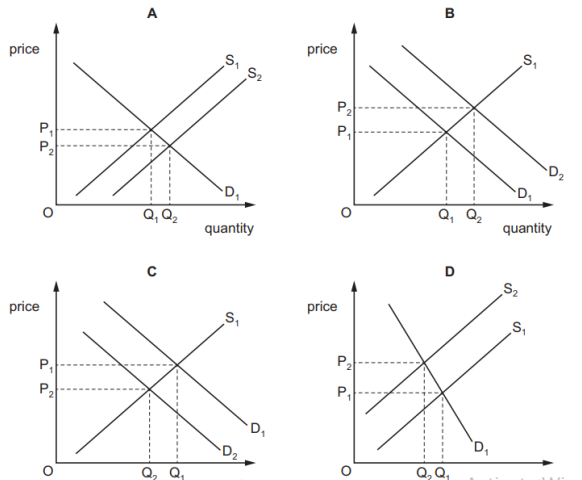
Time

2 hours

Instructions

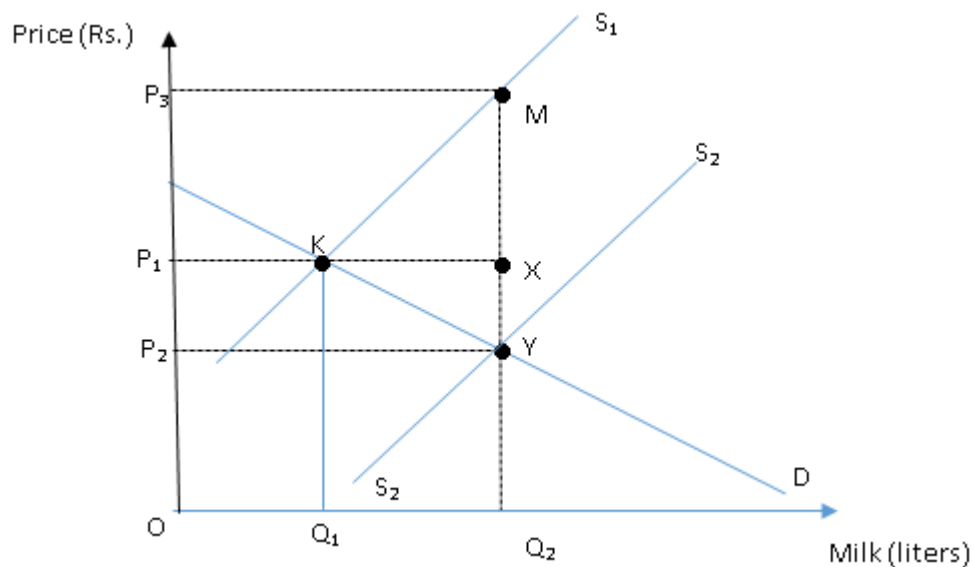
Answer all the questions.

1. The diagrams show changes in the demand and supply curves for a good. Which diagram shows the effect of a government providing a subsidy for the good?



- I. A
- II. B
- III. C
- IV. D
- V. None of the above

2. Assume that the government announces a subsidy to support milk production in Sri Lanka as shown in the diagram below.



Which of the following would represent the cost of the subsidy to the government?

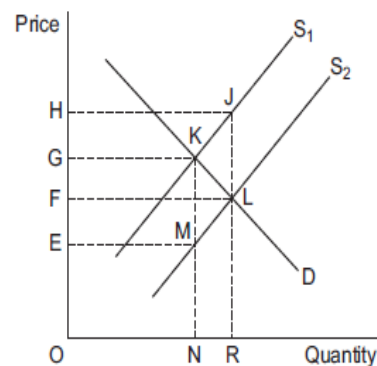
- I.  $P_2P_3MY$
- II.  $OP_2YQ_2$
- III.  $OP_1XQ_2$
- IV.  $OP_3MQ_2$
- V.  $P_1P_3MX$

3. Suppose that the market supply curve for a certain consumer good is upward sloping and the market demand curve is downward sloping. How does a unit subsidy on the product affect the consumer surplus and the producer surplus?

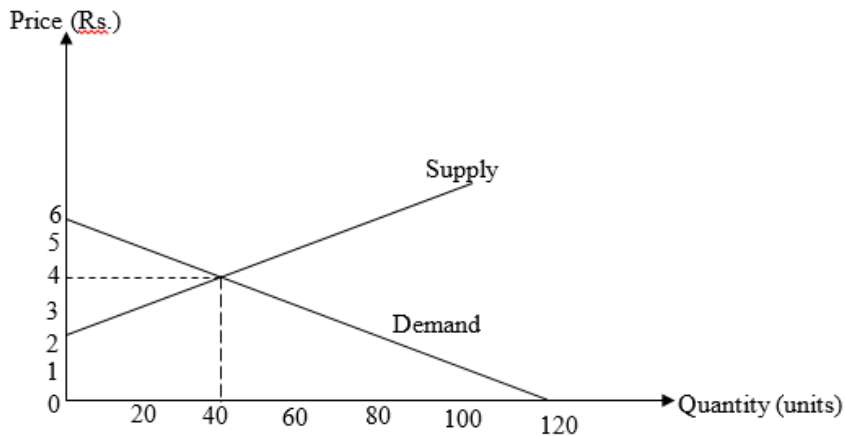
	Consumer Surplus	Producer Surplus
I.	Decreases	Decreases
II.	Decreases	Increases
III.	<u>Increases</u>	<u>Increases</u>
IV.	Increases	Decreases
V.	Increases	No change

4. In the diagram below shows, the government removes a subsidy that has granted earlier to manufacturers of cement. What is the area representing the reduction of government expenditure due this action?

- I. GKON
- II. GKME
- III. **FHJL**
- IV. FLRO
- V.  $(HJRO) - (GKNO)$



5. The graph shows the demand and supply curves in a competitive market for an agricultural commodity.



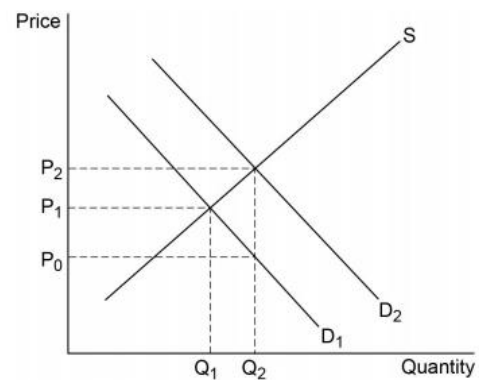
The government wants to promote the production of this commodity and decides to pay producers a subsidy of Rs. 2 per unit that they produce. The producer surplus after the subsidy is,

- I. Rs. 20.
- II. Rs. 80.
- III. **Rs. 90.**
- IV. Rs. 160.
- V. Rs. 180.

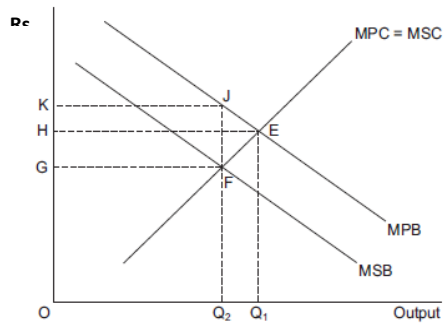
6. In the following diagram D1 shows the market demand for smoke alarms when consumers have imperfect information about the benefits of installing a smoke alarm. If consumers had full information, the market demand for smoke alarms would be D2.

Which one of the following policies is most likely to ensure that consumption and production of smoke alarms are at the social optimum level?

- I. A maximum price set at  $P_0$
- II. A maximum price set at  $P_2$
- III. A subsidy per unit equal to  $P_1 - P_0$
- IV. **A subsidy per unit equal to  $P_2 - P_0$**
- V. None of the above



7. The diagram below shows the marginal private benefit and marginal social benefit (MPB and MSB) curves and the marginal private cost and marginal social cost (MPC and MSC) curves for Good X.

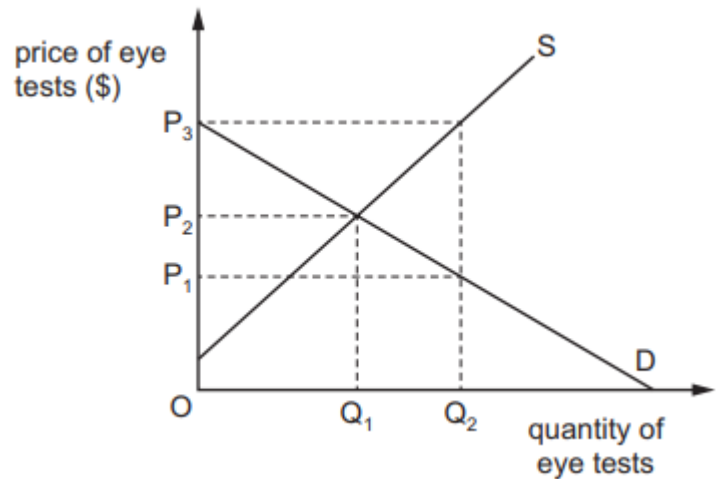


To reduce the market equilibrium output from  $Q_1$  to  $Q_2$ , the government could

- I. Introduce a subsidy of  $GH$ .
- II. Set a minimum price of  $OG$ .
- III. Introduce a per unit tax of  $HG$ .
- IV. Set a maximum price of  $OH$ .
- V. **None of the above**

8. The diagram shows the market for eye tests.

Which policy would enable the government to increase the number of eye tests from  $OQ_1$  to  $OQ_2$ ?



- I. a maximum price of  $OP_3$  per test
- II. a minimum price of  $OP_2$  per test
- III. a subsidy paid to opticians of  $P_3 - P_2$  per test
- IV. **a subsidy paid to opticians of  $P_3 - P_1$  per test**
- V. None of the above

9. A government wishes to raise the incomes of farmers without raising the price of food to consumers. Which policy should it use?

- I. a maximum price below the market price for food
- II. a minimum price below the market price for food
- III. **a payment of a subsidy to farmers to produce food**
- IV. a release of government food stocks onto the market
- V. Minimum price above the market price for food

10. The diagram shows the effect on the market for rice of a change in government policy that causes a shift in the supply curve from S to S<sub>1</sub>.

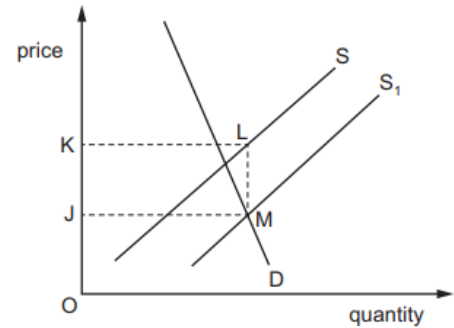
I. **the cost to the government of a subsidy to rice growers**

II. the extra saving to importers of the removal of a tariff on rice

III. the increase in consumer surplus from the introduction of a maximum price for rice

IV. the loss in government revenue from the reduction in a lump sum tax on rice

V. None of the above



11. The table shows the demand and supply schedules for a product before and after the government pays a subsidy of Rs.4 per unit to the producers.

price	quantity demanded (units)	quantity supplied before subsidy (units)	quantity supplied after subsidy (units)
6	140	60	100
8	120	80	120
10	100	100	140
12	80	120	160
14	60	140	180

What is the total government spending on the subsidy?

I. Rs.240

II. Rs.400

III. **Rs.480**

IV. Rs.960

V. Rs.1200

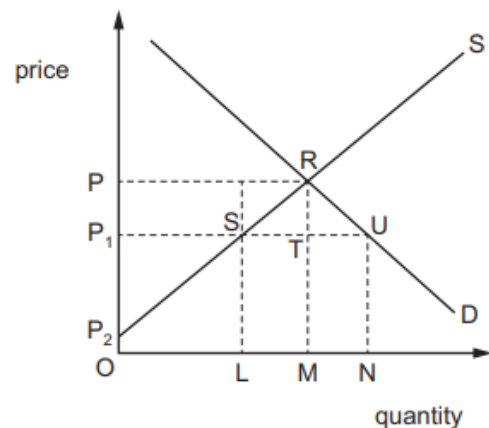
12. A price ceiling set below the market equilibrium price will result in

- I. An excess supply
- II. **An excess demand.**
- III. An equilibrium price.
- IV. An increase in supply.
- V. A decrease in demand.

13. The diagram shows the market for sugar which is initially in equilibrium at a price of OP.

A government then fixes a maximum price of OP<sub>1</sub>. What will happen as a result?

- I. a reduction in farmers' revenue equal to PRSP<sub>1</sub>
- II. expenditure on sugar will be equal to PRMO
- III. farmers' revenue would be P<sub>1</sub>UNO
- IV. **producer surplus will be P<sub>1</sub>SP<sub>2</sub>**
- V. None of the above



14. After a series of poor harvests, a government imposes an effective maximum price on cereals. What would be a consequence of this policy?

- I. Both rich and poor people would satisfy their demands equally.
- II. Illegal buying and selling through a black market would be prevented.
- III. **Rationing would be necessary to ensure a fair distribution of cereals.**
- IV. The market would fail to clear leaving a surplus of cereals.
- V. None of the above

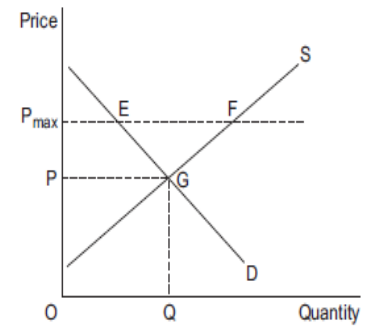
15. A government imposes a maximum rent in order to make rented housing more affordable. What is likely to be a long-run consequence if the maximum is set below the current free market level?

- I. a shortage of applicants for rented housing
- II. **a shortage of rented housing**
- III. an increase in supply to satisfy the increased demand for rented housing
- IV. an increase in the number of houses being rented
- V. None of the above

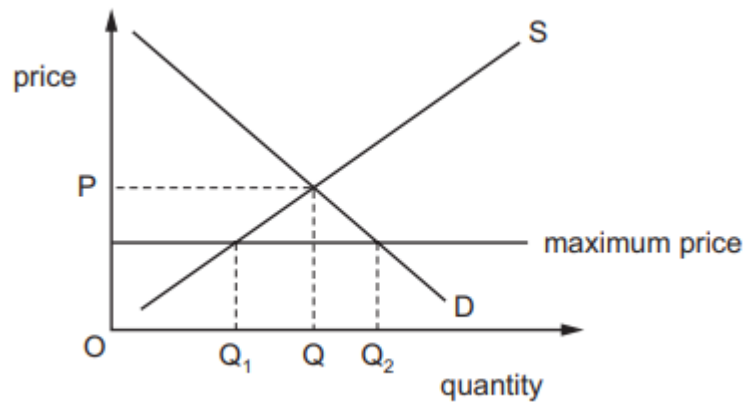
16. The diagram below shows the supply of, and demand for, soft drinks with the initial price at OP. A government now decides to impose a maximum price of P<sub>max</sub>.

The most likely outcome would be :

- I. Excess supply of soft drinks at EF.
- II. A shortage of soft drinks at EF.
- III. The equilibrium price OP not being maintained.
- IV. A reduction in price from Pmax to OP.
- V. **None of the above**



17. The diagram shows a market subject to a maximum price.



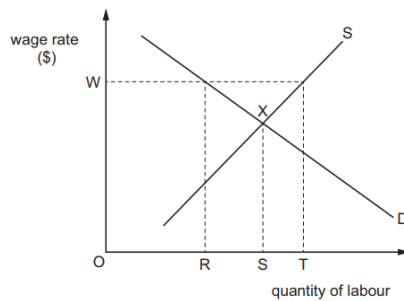
What will happen if the maximum price is removed?

- I. There will be allocation by a queuing system.
- II. There will be allocation by government rationing.
- III. There will be allocation by seller's preference.
- IV. **There will be allocation by the price system.**
- V. None of the above

18. Which type of government intervention runs the risk of causing shortages?

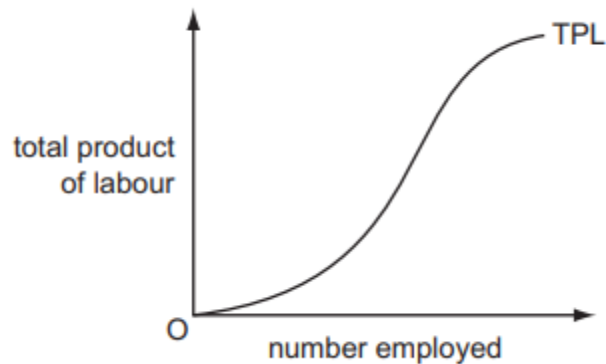
- I. **maximum price controls**
- II. specific indirect taxes
- III. subsidies paid to some producers
- IV. taxes on company profits
- V. none of the above

19. The diagram shows the demand for and supply of labour in an industry. The original equilibrium is X. A trade union then negotiates a wage rate of W. What identifies the change in employment?



- I. OR
  - II. OT
  - III. **RS**
  - IV. RT
  - V. OW
20. What represents the transfer earnings of the factor enterprise?
- I. Excess profit
  - II. **Normal profit**
  - III. Return on capital
  - IV. Start-up costs
  - V. Total cost
21. One of the “real” flows in the circular flow model of income is
- I. **The flow of goods and services going from firms to households.**
  - II. The flow of factor services going from firms to households.
  - III. The flow of goods and services going from households to firms.
  - IV. The flow of money payments going from firms to households.
  - V. The flow of money payments going from households to firms.
22. If there are implicit costs of production
- I. **Accounting profit will exceed economic profit.**
  - II. Economic profit will always be Zero.
  - III. Economic profit will exceed accounting profit.
  - IV. Accounting profit will always be zero.
  - V. Economic profit and accounting profit will be equal.
23. The diagram shows the total product of labour curve for a firm whose only variable factor input is labour.





What explains the shape of the curve?

- I. diminishing marginal disutility of work
- II. increasing marginal disutility of work
- III. technical diseconomies of scale
- IV. **the law of variable proportions**
- V. None of the above

24. Which cost incurred by a firm manufacturing shirts is a variable cost?

- I. Buildings insurance
- II. **Raw materials**
- III. Interest on bank loans
- IV. Rent on property
- V. CEO salary

25. The table shows output and total costs of a firm with three workers.

	Output per worker	Average cost
Week 1	5	1500
Week 2	6	1600
Week 3	7	1700
Week 4	8	1800

How did output per worker and average cost change over the period?

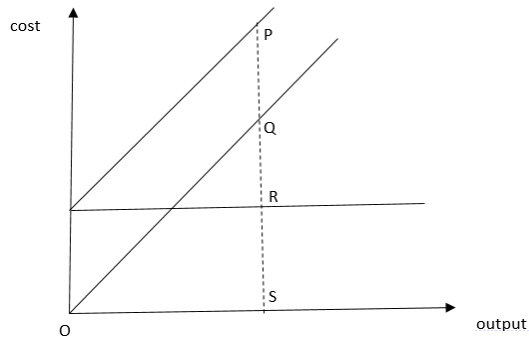
	Output per worker	Average cost
I.	Decrease	No change
<b><u>II.</u></b>	<b><u>Increase</u></b>	<b><u>Decrease</u></b>
III.	Increase	No change
IV.	No change	Increase
V.	Decrease	Increase

26. The table shows a firm's average revenue and average cost. What level of output will give the maximum profit?

	Output (units)	Average revenue	Average cost
I.	5	10	30

II.	10	20	20
III.	15	25	15
<b>IV.</b>	<b>20</b>	<b>30</b>	<b>18</b>
V.	25	10	25

27. The diagram shows the fixed costs, variable costs and total costs of a firm.



Which distance represents the firm's fixed costs?

- I. **PQ**
- II. PS
- III. QR
- IV. QS
- V. RS

28. The shape of the total cost curve of a firm in the short run is determined by,

- I. The behaviour of average fixed cost
- II. The change in technology
- III. The behaviour of average total cost
- IV. **The behaviour of average variable cost**
- V. The behaviour of returns to scale

29. Dimitry owns a firm that produces and sells bottles of lemonade. He only sells one size of bottle. How would Dimitry calculate the total revenue of the firm?

- I. multiply the quantity sold by the cost per bottle
- II. **multiply the quantity sold by the price per bottle**
- III. multiply the quantity sold by the profit per bottle
- IV. multiply the quantity sold by the tax per bottle
- V. multiply the quantity sold by the average cost per bottle

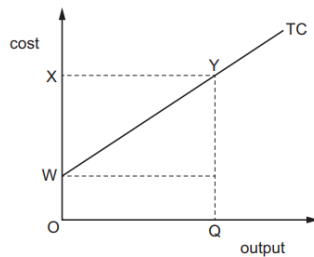
30. Normal profit is defined as the rate of profit

- I. For a firm over a period of years.
- II. For an industry over a period of years.
- III. **Required to keep resources in their present usage.**
- IV. Required to keep the firm in a state of equilibrium.
- V. Earned by producing at the point where marginal cost equals marginal revenue.

31. Which one of the following factors of production is likely to be fixed in the short run?

- I. **The location of the firm**
- II. The number of employee hours
- III. The amount of electricity (unit) consumed
- IV. The amount of stationery used
- V. The amount of raw materials used

32. The diagram shows a firm's total cost (TC) curve.



What is the average variable cost if the firm produces an output of OQ?

- I.  $OX/OQ$
- II.  $OW/OQ$
- III.  **$WX/OQ$**
- IV.  $WY/OQ$
- V.  $WO/QY$

33. At the current level of output of a perfectly competitive firm, the marginal cost is Rs.60. The average variable cost is Rs. 50. The average fixed cost is Rs.30 and the product price is Rs. 60. Which of the following statements is true for this firm?

- I. Economic profit is zero because marginal revenue equals marginal cost.
- II. **Economic profit is negative because total revenue is less than total cost.**
- III. Economic profit is positive because total revenue is greater than total cost.
- IV. Economic profit is positive because price is greater than average variable cost.
- V. Economic profit is zero because price equals average total cost.

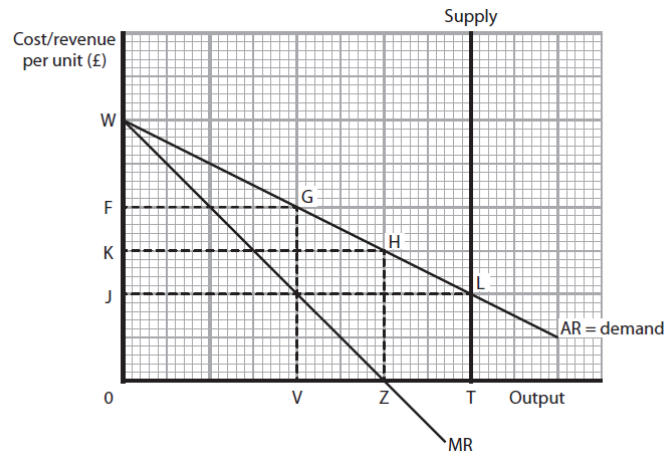
34. What cannot be changed in the short run?

- I. the level of stock held by firms
- II. **the level of technology available**
- III. the market price of goods
- IV. the output of individual firms in an industry
- V. both II & III

35. The diagram shows the supply, demand and marginal revenue schedules for parking spaces in a local government car park.

What quantity will ensure that the local government maximizes total revenue?

- I. Zero
- II. OV
- III. **OZ**
- IV. OT
- V. Any quantity between VZ



36. Following extract shows the marginal cost of producing product X in the run.

No of Units of X	1	2	3	4	5	6	7
Marginal Cost	30	18	15	25	40	56	80

If total fixed cost is Rs. 50/- , What is the production quantity at which the average cost is minimum in the short run.

- I. 2 units
- II. 3 units
- III. **4 units**
- IV. 5 units
- V. 6 units

37. A firm has total production cost of Rs.200 000. Its average fixed cost is Rs.120 and its average variable cost is Rs.80. What are the firm's total fixed costs?

- I. Rs 12,000
- II. Rs. 40,000
- III. Rs. 80,000
- IV. **Rs. 120,000**
- V. Rs. 20,000

38. Which of the following are components of fixed cost?

A-Amortization payments

B-Property taxes

C- Cost of raw material

D-License fees

E-Interest payments for capital injected

F-Wages paid to workers

G-Normal profits.

I. A, D, E, G

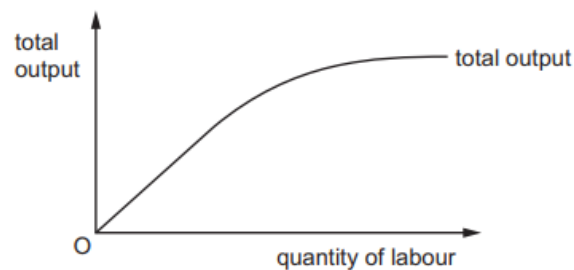
II. B, D, E

III. **A,B,D,E,G**

IV. A,B,D,E,F

V. A, B, D,E

39. The diagram shows the short-run relationship between the total output of a firm and the quantity of labour.



What can be concluded about the firm?

I. It is experiencing increasing returns to scale.

II. It is experiencing constant returns to scale.

III. The marginal physical product of capital is constant.

IV. **The marginal physical product of labour eventually diminishes.**

V. Both 'III' and 'IV'

40. An economist calculates that a firm has incurred the following production costs over the course of a year.

	Rs. (thousands)
Owners' lost salary by quitting the job	200
Normal profit	300
Variable cost on material	600
Rent paid to owner's wife	80

Advertising expenditure	250
Interest on bank loans	500
Interest born by the owner for his personal loan to provide initial capital	140
Fixed cost on Machinery	2000
Electricity bill of office space for accounting Staff	20

By how much does total cost as defined by an economist exceed the total cost as defined by an accountant?

- I. **Rs. 640,000**
- II. Rs. 720,000
- III. Rs. 300,000
- IV. Rs. 1,210,000
- V. None of the above

41. A firm has the choice between five levels of output. The table shows the total cost and total revenue of producing at each output level. The firm could sell whatever output it produces.

output (units)	total cost (\$)	total revenue (\$)
1000	8 000	10 000
2000	12 000	18 000
3000	19 000	24 000
4000	23 000	28 000
5000	25 000	25 000

The firm decides to produce 4000 units. What is the firm's aim?

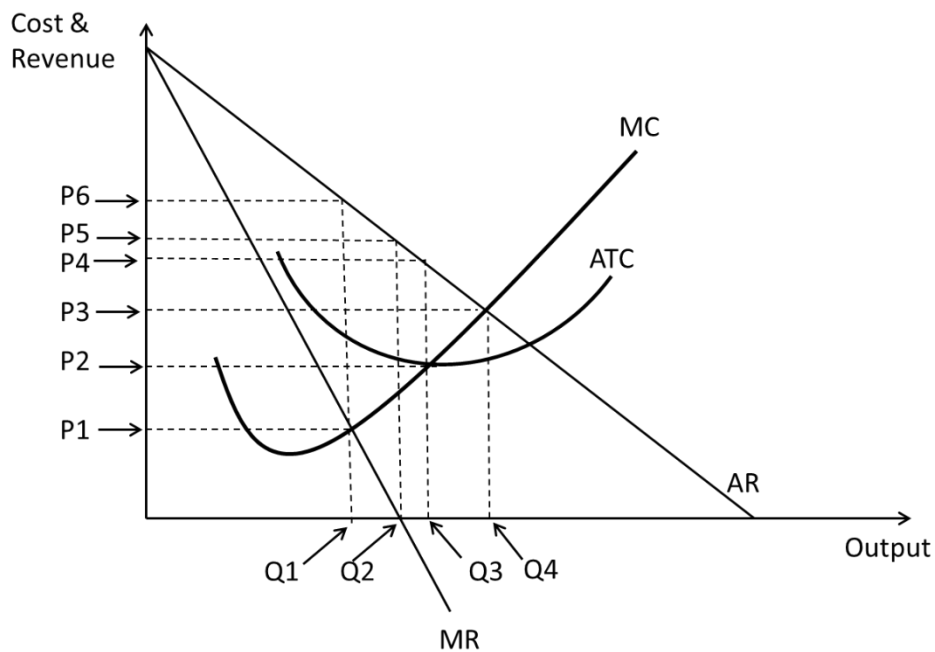
- I. to maximise profit
- II. to maximise sales
- III. **to maximise revenue**
- IV. to minimise average costs
- V. to maximise revenue & profit both

42. When marginal product of the short-run production function of a firm is negative,

- I. The total product is maximized
- II. The total product is rising but at a decreasing rate
- III. The average cost is minimized
- IV. The marginal cost is negative

V. The total product starts to decrease.

43. The diagram shows cost and revenue curves for a firm.



The firm may seek to either maximize profit or maximize revenue. What is the correct price and quantity combination for each?

	maximize profit	maximize revenue
I.	P2 & Q3	P3 & Q4
II.	P3 & Q4	P6 & Q1
III.	P6 & Q1	P3 & Q1
IV.	<b><u>P6 &amp; Q1</u></b>	<b><u>P5 &amp; Q2</u></b>
V.	P5 & Q2	P6 & Q1

44. A firm produces good X and good Y when the marginal product of both labour and capital is diminishing. The table shows the marginal products at a given output.

	Marginal product of labour (units)	Marginal product of capital (units)
Good X	4	6

Good Y	8	4
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The firm should use ....1....labour and .....2.....capital in the production of X and .....3..... labour and .....4..... capital in the production of Y.

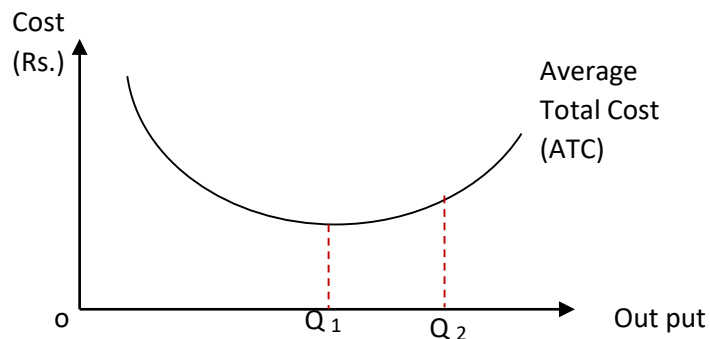
Which words complete the gaps 1, 2, 3 and 4 if the firm wished to increase productive efficiency?

	1	2	3	4
I.	More	Less	More	Less
II.	More	Less	Less	More
III.	Less	More	Less	More
IV.	<u>Less</u>	<u>More</u>	<u>More</u>	<u>Less</u>
V.	More	Less	Less	More

45. Economies of scale will

- I. Always lead to an increase in abnormal profits.
- II. Cause average costs to increase.
- III. Benefit multinational companies
- IV. **Cause a fall in long run average costs.**
- V. Lead to a proportionate increase in output.

46. The diagram shows how a firm's average total cost changes as it employs of all its factors of production, including capital and labour.



As the firm increases its output from  $OQ_1$  to  $OQ_2$ , the diagram illustrates

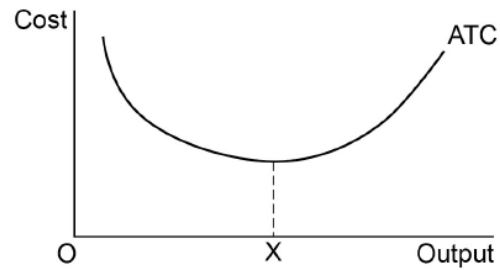
- I. The benefits of monopoly power,
- II. The benefits of increased specialization
- III. **Diseconomies of scale.**
- IV. Increasing returns to scale,
- V. Increased productive efficiency.



47. The diagram below shows a firm's average total cost curve (ATC), with the firm producing an output of OX. ?

The firm's productive efficiency will improve if the

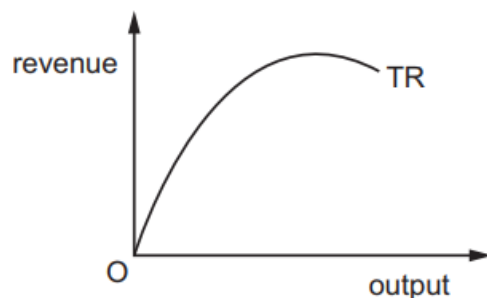
- I. Firm makes no adjustment to output
- II. ATC curve shifts upwards for any given level of output.
- III. **ATC curve shifts downwards for any given level of output.**
- IV. None of the above
- V. Both I and III



48. A company mining cobalt invests in machinery to replace some workers. Eventually diseconomies of scale occur. What could cause this situation?

- I. No effect to the costs
- II. **As more cobalt is mined average costs increase.**
- III. Fewer workers are needed to produce the required output.
- IV. Output per hour increases as more machinery is used.
- V. Overhead costs are spread as output increases.

49. The diagram shows a firm's total revenue curve.



At the curve's highest point

- I. Marginal revenue is equal to marginal cost.
  - II. Average revenue is equal to average cost.
  - III. Marginal revenue is equal to average revenue.
  - IV. **Marginal revenue is zero.**
  - V. None of the above
50. A firm operates at the maximum point on its average product curve. What necessarily follows?
- I. **Average variable cost is at a minimum.**
  - II. Marginal cost is at a minimum.
  - III. Marginal product is at a maximum.

- IV. Total profit is at a maximum.
- V. None of the above