

HM 116: Principles of Economics

End Semester Exam

Date: December 1, 2018.

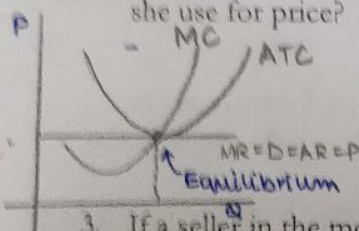
Duration: 1.5 hours

Marks: 50

1. In the following market structures, how much percentage share of the market an individual firm can possibly have? (4 marks)

- Perfectly competitive markets 2-3 %.
- Monopolistic competition 15-20 %.
- Oligopoly 30-40 %.
- Monopoly 100 %.

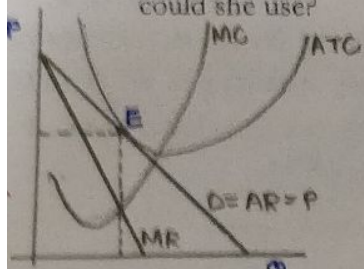
2. If a seller in the perfectly competitive market wants to increase her sales, what strategy should she use for price? (2 marks)



In a p-c market an individual seller is already selling at the lowest price. Any more \downarrow in price will lead to the seller making loss.

Therefore, only strategy that can be applied is increase in production.

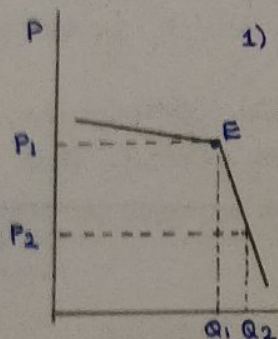
3. If a seller in the monopolistically competitive market wants to increase her sales, what strategies could she use? (4 marks)



Here, the seller faces the same problem with \downarrow prices \Rightarrow firm will start incurring losses.

However, since the products are not completely homogeneous, the seller can use advertisements to reach out to more people. She can advertise on the product image, services, some unique thing that differentiates the product etc.

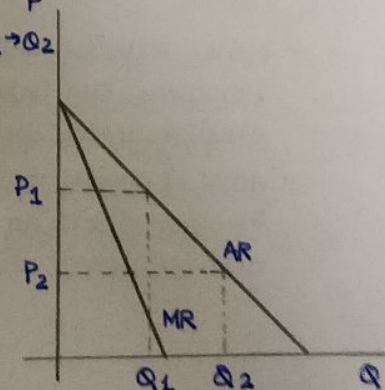
4. Why is it so difficult for an oligopolist to increase his sales by reducing prices? Can a monopolist increase his sales by lowering the prices? Explain by drawing curves. (6 marks)



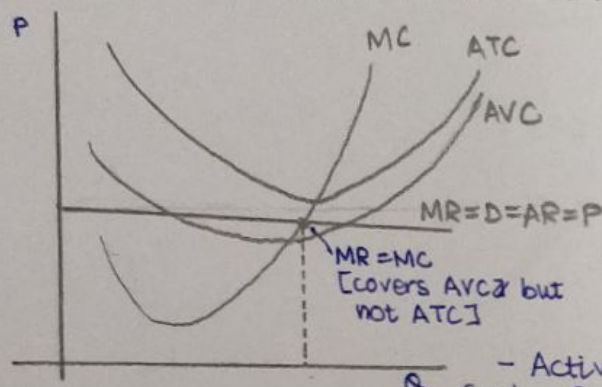
- 1) Oligopolist faces a kinked demand curve where he's stuck at the kink i.e. equilibrium is reached at the kink.

If he reduces his price, other players in the market will do so too. This leads to not much benefit overall. In the figure price is decreased from $P_1 \rightarrow P_2$ yet quantity Q only increases a little $Q_1 \rightarrow Q_2$.

- 2) Monopolist, on the other hand can \uparrow his sales by lowering the prices as more people will be willing to buy the product & they have nowhere else to go since there is only 1 player in the market.



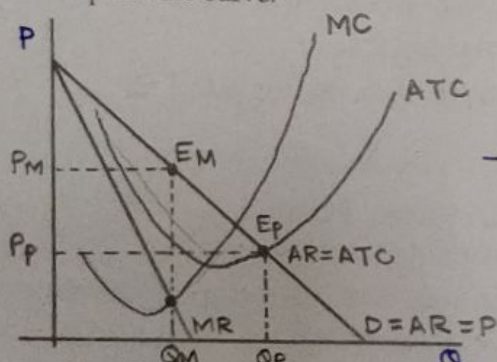
5. Draw up MC, MR, AR, ATC and AVC curves in a perfectly competitive market such that AVC is below the price line and ATC above it. Why should a public enterprise (company owned by the government) want to continue its activities like this? Why is it desirable by the society? (4 marks)



- A public enterprise wants to continue its activities because
 1. No private firm or will risk their money for this.
 2. Government will bear the fixed cost as long as the average variable cost gets covered.

After all, competition - Activities like pipeline etc. are examples of such. Public [society] desires this as these are

- some of the basic requirements.
6. Draw a demand curve with which you can show that a monopolist can exploit the consumers. Explain the curve. (2 marks)



E_M is the equilibrium point for a monopolist and E_P for a perfectly competitive market.

- As one can see, monopolist charges a lot ($P_M > P_P$) and in return provides much fewer goods ($Q_M < Q_P$). Thus, a monopolist exploits the consumers by taking a lot of price for few goods. This can even be catastrophic if he controls a necessity of life.

7. Should the natural monopolies (like electricity) be owned by the government or private sector? Discuss which natural monopoly managing system can lead to maximum social welfare. (3 marks)

- Government. This is too much power (as in previous question) for a private capital-minded firm to handle & it plus natural monopolies have a huge centralized system, maintenance of which is out of the reach of a single private firm.

- Government can issue tenders for private companies, which they can buy & serve for a pre-defined amount of period. This will keep the private comp in check of no-work & exploitation, and let govt control the prices. It

8. List out two most important factors that determine which currency can rise to be the international currency. (4 marks)

- How easily the currency is obtainable: Pound Sterling became an international currency as England had its empire widespread & easily available. For USD, it was the Marshall plan.
- How easily the currency is convertible: In case of Pound Sterling gold standard came to rescue as it made conversion easier.

can also help escape the vices of govt such as corruption.

9. Gir is a popular tourism spot in Gujarat. Do you think Hunters' dilemma can apply there? Have we reached Nash equilibrium there? (4 marks)

- Yes, Hunters' Dilemma can be applied there as they host the majestic Asiatic Lions which are very rare, as well as there are nearby forest tribes who might benefit from the hunting.

- Nash equilibrium has been avoided there due to the stepping in of Gujarat Government. This intervention has prevented the hunting of Lions & ^{has} also been the reason for tourism development - a regular source of income of locals. \Rightarrow Win-win for everyone.

10. Why would a philosophy like socialism, which believes in ultimate equality and justice, tend to become a communist society during its implementation phase? (3 marks)

- One of the central requirements of communism is "redistribution of resources". The worker class of the nation hold no such power as to accomplish such a humongous task. Therefore when the workers of the world rise,

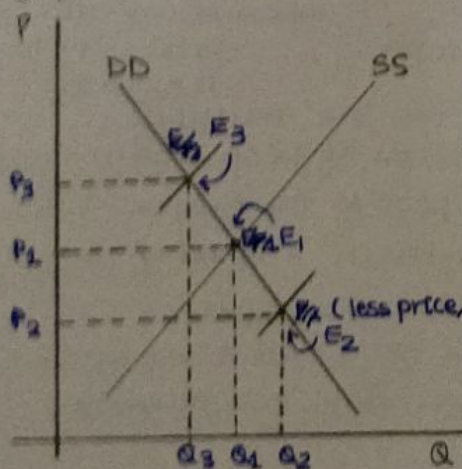
and break their chains they're usually met with fire-power or in general violence from governing authority which stirs up even more violence leading to thefts, killings, kidnapping etc "for humanity sake".

11. Give any two practices of socialism that show that it is human centric as opposed to capitalism that is focused on material wealth. (2 marks)

= Free food, health & education.

= Minimal difference of income and employment for all.

12. Consider a demand supply framework. For a market of petroleum, which is imported at a high cost, should the government tax it or give subsidy? Explain the impact of both by drawing graphs. (4 marks)



Petroleum has become one of the crucial necessities in the current world and hence it has a steeper demand curve.

CASE 1 - tax: When govt taxes petroleum, its demand \downarrow but not by a large amount [ofcourse, a larger tax will trigger inflation but we're not talking about that]. A ~~minimal~~ tax just enough to cover govt operations.

CASE 2 - subsidy: Decrease in Δ prices leads to increase in demand. Now, there are increased # of people buying petroleum at a cheaper rate \Rightarrow huge losses for the govt and

hence, for the society. So this is definitely not the favorable option.

\rightarrow Therefore the govt should go for taxes as it will help govt break-even and use the tax collected for public welfare. Win-win for the govt & society.

(2 marks)

13. Why do we need to calculate real GDP?

nominal GDP
real GDP

Nominal GDP is just current production x current prices.

It does not reflect the changes in ^{consumption} habits of people as well as inflation. Also, Nominal GDP shows growth which isn't there. Its just ↑ in prices over time.

14. The CPI is 132 for 2017. Calculate real GDP for the current GDP value of Rs. 45,00,000. (1 mark)

$$\text{Real GDP} = \frac{\text{Nominal GDP} \times 100}{\text{price index}}$$

$$= \frac{45 \times 10^6 \times 100}{132} = ₹349091$$

15. The bank interest rate increases by 3%. Explain how the money supply would be affected. (2 marks)

With increase in interest rate, people would be less likely to withdraw money from banks. Hence, their consumption would decrease and money circulation in the market would decrease.

- This step is often taken by the government to curb & / regulate inflation - more money in society.

16. Say inflation has started increasing in India. What should be Reserve Bank buy - government bonds or rupees in exchange for dollars? (1 mark)

Rupees in exchange for dollars. Buying bonds will only get more money in the market. ~~This~~ on the other hand increases the demand of ₹.
 ₹ in exchange for \$ \Rightarrow regulate the supply.

17. Recession hits the economy. The government is ready to infuse money into the economy but it wants the expenditure to generate maximum effect. Use the Keynesian multiplier formula and explain in whose hands the money should be put. (2 marks)

$$\text{Government spending multiplier} = \frac{1}{1 - \text{mpc}} \quad \text{mpc} = \text{marginal propensity to consume.}$$

\Rightarrow Greater the value of mpc, more will be the multiplier.

Hence money should be put in p-hands of people with greater marginal propensity to consume \Rightarrow poor of the Nation. Since they will have a tendency to spend more instead of saving [they can't afford to save] & hence money multiplies.

\Rightarrow more demand & hence supply must be increased \Rightarrow employment ↑ and spending ↑. This cycle continues and gets recession economy out of recession.