



University of Kelaniya - Sri Lanka
Centre for Open and Distance Learning



Bachelor of Business Management (General) Degree
First Examination (External) – 2007

BMGT E 1035 – Business Economics

No. of Questions: Eight (08)

Time: 03 hours

Answer any five (05) questions.

- 1) (a) Discuss the importance of the concept of price elasticity of demand in economic analysis
(08 marks)
- (b) “Suppose that a 20% increase in the price of good Y results in an increase in the consumption of good X of 8%. This is an example of the substitution effect.” Do you agree with this statement? Explain the reasons.
(05 marks)
- (c) (i) Given the following data for particular product find the equilibrium price and quantity.
 $P = 80 - Q$ (Demand)
 $P = 20 + Q$ (Supply)
(04 marks)
- (ii) Suppose that the supplier must pay a tax Rs.6 per unit. Find out new equilibrium price and quantity.
(03 marks)
(Total 20 marks)
- 2) (a) Explain the concepts of marginal utility and total utility by using an example.
(05 marks)
- (b) Explain and illustrate consumer’s equilibrium by using the indifference curve technique.
(04 marks)
- (c) Explain why the long run average cost curve takes “U” shape.
(05 marks)
- (d) Illustrate the income and substitution effects using indifference curves and budget constraints
(06 marks)
(Total 20 marks)

- 3) (a) Farmer, Gunadasa has a 100 acre of land and he works there with one laborer and one tractor. Explain what might happen to his output (total, marginal and average) as he hires more and more laborers with the same capital. (08 marks)
- (b) Distinguish between the factors which account for increasing returns to scale and the decreasing returns to scale. (06 marks)
- (c) What is meant by the production expansion path? (06 marks)
(Total 20 marks)
- 4) (a) Robin is one of many firms in the market for soap which is in the long run equilibrium.
(i) Show Robin's profit maximizing output and price. (05 marks)
(ii) What is Robin's profit? How is it different from the short run profit? Explain. (05 marks)
- (b) The demand curve and the total revenue curve of a firm are given below.
- $$Q = 400 - 2P$$
- $$TC = 35Q + 0.05Q^2$$
- (i) What is the output and price at maximum level?
(ii) Calculate the profit. (10 marks)
(Total 20 marks)
- 5) (a) Briefly explain the concepts of product differentiation and price discrimination (05 marks)
- (b) How does the kinked demand curve model lead to price rigidity in an oligopolistic market? (05 marks)
- (c) Briefly explain why the monopolistic competitive firms fail to maintain supernormal profits in the long run. (04 marks)
- (d) By using graphs briefly explain how the total industry demand is divided among the cartel members. (06 marks)
(Total 20 marks)
- 6) (a) Suppose that you are running a firm that sells consumer goods. The government has just announced a cut in income tax rates. What effect would you expect from this to have on your sales? (03 marks)

- (b) you are given the following information of a hypothetical economy (All the values are in rupees millions)

$$C = 240 + 0.4 y_d$$

$$T_x = 70 + 0.6 y$$

$$T_r = 250$$

$$I = 160$$

$$G = 320$$

- (i) Workout the equilibrium level of income for this economy.
(03 marks)
- (ii) What is meant by multiplier ? Calculate the expenditure multiplier for the above economy
(04 marks)
- (iii) What would be the values of the multiplier for the following values of the MPC (marginal propensity to consume)
a) 0.4 b) 0.75 c) 0.95
(06 marks)
- (c) Explain the relationship between marginal propensity to consume (mpc) and marginal propensity to savings (mps).
(04 marks)
(Total 20 marks)
- 7) (a) Briefly explain the views of the Classical economists and the Keynesians for the demand for money.
(05 marks)
- (b) Explain what will happen to the equilibrium interest rate and national income if,
i) the government increases its own government expenditure
ii) better bank services increases demand for money
iii) the authorities relax monetary policies
(09 marks)
- (c) Briefly explain how the slope of the LM curve affects determining the effectiveness of the fiscal policy.
(06 marks)
(Total 20 marks)
- 8) (a) Explain how the study of economics helps a business manager in decision making.
(08 marks)
- (b) Bring out clearly the distinction between cost push and demand pull inflations.
(06 marks)
- (c) What are the current trends of unemployment in Sri Lanka.
(06 marks)
(Total 20 marks)