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SUBJECT- ECONOMICS

Test Code – CFN 9269

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1. Price taker firms are firms in perfectly competitive markets. In such a market product sold are homogenous and also due to perfect knowledge with buyers and almost zero transport and transaction cost, uniform price prevails for a given product. So there is no need to advertise. If they advertise they will end up making a loss in the long run.

[Ans.: C]

2. Apart from profit maximization, firms pursue other goals as well. Baumol contends that firms try to maximize sales. A. A Berle & G.C. Means point out that in large business corporations managers try to maximize their utility function. H.A. Simon, in this context argues that firms have 'satisficing' behaviour & strive for profit that are satisfactory.

[Ans.: B]

3. Cold drink industry in India is dominated by two multinational giants – Pepsi and Coke plus a very few regional /national players. A market characterized by the presence of few sellers & large buyers is oligopolistic in nature.

If there are many sellers selling homogeneous goods, we have perfect competition. Many sellers selling differentiated products makes monopolistic market & one seller selling to many buyers defines a monopoly.

[Ans. : D]

4. Economies are the benefits that a firm gets when it expands its output. Economies associated with distributing the product are known as selling economies associated with manufacturing /production are known as technical economies whereas those associated with maintaining inventories are known as inventory economies.

[Ans. : D]

5. In a monopoly there is only one firm. So it is dominant in making a price which the buyers have to accept it. A firm in perfect competition is a price taker as there are large number of buyers & sellers and they jointly determine the price.

[Ans. : A]

6. According to (AP) mathematical relationship. If average product is more than marginal product (MP), AP tends to increase If AP is less than MP, AP tends to decrease, MP intersects AP at its highest point, where the two become equal….

[Ans.: A]

(B) **Is wrong because the law of increasing returns to scale relates to the effect of change in scale**

(C) **Is wrong because economies of scale arise due to expansion in production.**

(D) **Is wrong because when industry expands beyond optimum one encounters external diseconomies.**

7. By definition if few firms are selling homogenous products it is known as perfect oligopoly. If they sell differentiated products it is known as imperfect oligopoly. If few firms decide to cooperate in matters of price fixing, market sharing, etc. it is known as collusive oligopoly & if they compete among themselves it is a case of non collusive oligopoly.

[Ans.:C]

8. The formula to calculate marginal revenue (MR) is,

MR = $\frac{\Delta TR}{\Delta Q}$

Here Δ TR = £ 65025 & Δ Q = 75 – 60 = 15

$\therefore$ MR = $\frac{65025}{15}$ = 4335

[Ans.:B]

9. When there is one seller & one buyer in a market, there is monopoly on both (bi) sides (lateral) so it is known as bilateral monopoly.

In duopoly there are two sellers. In monopsony there is a single buyer & in oligopsony there are few buyers facing many sellers.

[Ans.:D]

10. Long run average cost curve (LRAC) is derived from various short run average cost curves (plant curves) (SRAC) LRAC envelopes various SRACs so it is known as envelope curve. It is also called as planning curve.

[Ans.:A]

11. Price discrimination is a practice of selling a given commodity to different buyers at different prices. Firms discriminate prices in order to maximize profits, enjoy economies of scale, capture foreign market & also to dispose off surplus stock.

[Ans.:B]

12. TC = TFC + TVC

Here TFC = AFC $\times$ Q
= 7 x 30 = 210

$\therefore$ 300 = 210 + TVC

$\therefore$ TVC = Rs. 90

[Ans.: C]

13. $MR_n = TR_n - TR_{n-1}$

For n = 16 $\Rightarrow$TR = P.Q. = 18 $\times$ 16 = 288

For n = 15 $\Rightarrow$ TR = P.Q. = 20 $\times$ 15 = 300

$\therefore$ MR_n = 288 – 300

= – (Rs.12)

[Ans.:C]

14. Total variable cost curve slopes upward as it is directly related to the level of output. Total fixed cost curve is horizontal as it is independent of the output produced. Average variable cost curve us U – shaped.

Average fixed cost curve is rectangular hyperbolic as area under all the points on this curve (which is TFC) remains the same.

[Ans.:D]

15. The firm's MC curve which gives the marginal cost corresponding to each level of output is nothing but firm's supply curve that gives various quantities the firm will supply at each price. For prices below AVC, the firm will supply zero units because the firm is unable to meet even its variable cost. For prices above AVC, the firm will equate price & MC. When price is high enough to meet the AVC, a firm will decide to continue its production.

[Ans.:D]

16. A firm encounters diminishing returns when marginal productivity of variable factor starts declining. This is the second stage of the law of variable proportion wherein output increases at a decreasing rate when more and more of a variable factor is added to the fixed quantity of other factors.

[Ans.:B]

17. Pure competition is a narrow concept as compared to perfect competition. Pure competition is a market characterized by presence of large number of buyers & sellers, homogeneous products & freedom of entry and exit of firms.

[Ans.:D]

18. Production in economics is defined as a process of adding or creating utility. Utility can be added /or created by charging form of matter (form utility); by charging place of commodity (place utility) and by charging the time of availability of commodity (time utility).

[Ans.:A]

19. Price discrimination is a practice of selling the same commodity to different buyers at different prices. Cost of production for a discriminating firm remains the same. Equilibrium condition is MR = MC. If a discriminating firm is selling its product in two markets A and B then for profit maximization MR in both these markets should equal MC.

[Ans.:B]

20. Producer aims at maximizing output. In the short run output becomes maximum at the end of stage II of law of variable proportion. So this stage is known as stage of economic rationality/ optimality/ achievement. The remaining two stages are called stages of economic nonsense as the objective of the producer does not get fulfilled.

[Ans.:B]

21. Oligopolies can be classified in a number of ways depending on different criteria. In pure oligopolies firms sell homogeneous products.

In open oligopolies new firms can easily enter the industry whereas in closed oligopolies new firms cannot enter the industry for a variety of reasons.
In collusive oligopoly, few firms come to a common understanding regarding price and /or output fixation.

[Ans.:D]

22. An entrepreneur brings other three factors together for the purpose of organizing production in order to maximize profits. In doing this he coordinates among the factors and bears risks and uncertainties of business. He is also responsible for introducing innovations (i.e. doing something new to increase profits) which now – a – days is regarded as entrepreneur’s most important function.

[Ans.:A]

23. Economic theory is based on certain implicit assumptions. One such assumption is that economic actors are rational i.e. they indulge in self – interest maximizing behavior. In context of firm, irrespective of its size & nature of ownership, it translates into profit maximization as its ultimate goal.

[Ans.:B]

24. The law of variable proportions explains short run output behavior when all except one factor remains fixed. It assumes that technology does not change and also that factors can be used in variable proportions.

[Ans.:A]

25. Allocative efficiency can be interpreted to mean a situation where consumer exploitation is zero. This is possible only when the price of a commodity equals the marginal cost of producing that unit of output i.e. AR(P) = MC

[Ans.:C]

26. The law of variable proportions is based on short run production function wherein output labor and capital are expressed in physical terms and not in monetary terms. This law explains what happens to output when extra units of labor are added to fixed quantity of other inputs. The law is based on the assumption of constant state of technology.

[Ans.:A]

27. Selling outlay refers to the money spent by firms on advertising its product. Such expenditure is not required in perfect / pure competition as all firms sell homogenous goods at uniform price. Similarly in monopoly selling outlays are unnecessary as there is absence of competition.

In monopolistic competition due to product differentiation firms have to spend substantial sum on advertising to convince buyers to purchase their brand.

[Ans.:A]

28. LAC curve is derived from SAC curves. LAC curve envelopes all the SAC curves. It is tangent to all the SAG curves. It is to be noted that LAC curve is not tangent to the minimum points of all the SAC curves. When the LAC curve is declining, it is tangent to the falling portions of the SAC curves as all these plants are being operated at less than their full capacity.

[Ans.:A]

29. Market for milk satisfies the requirements for a perfectly competition market as there are large number of buyers & sellers selling homogeneous commodity and there is free entry & exist sellers.
Cola industry & cable television industry is oligopoly due to the presence of few firms.
Electricity industry is generally a monopoly.

[Ans.:D]

30. Marginal product of a variable input is defined as the change in total output occurring due to the employment of an additional unit of variable factor.

[Ans.:B]

31. In the long run a firm in monopolistic competition when in equilibrium operates on the falling portion of AC curve and not at its lowest point. This means that there is excess capacity in the firm which implies that resources are not fully employed/ utilized.

[Ans.:B]

32. Opportunity cost is defined as the value, profit or benefit sacrificed from the next best use of a given resource (which is foregone)

[Ans.:C]

33. Oligopoly is a market characterized by the presence of few firms selling homogenous or differentiated products to a large number of buyers.

If the product is homogeneous it is known as pure / perfect oligopoly and if the product sold is differentiated it is a case of imperfect oligopoly.

[Ans.:A]

34. If TR is divided by the number of units sold we get average revenue (AR) and not marginal revenue (MR). MR is obtained by dividing change in TR by the change in units of output sold.

[Ans.:D]

35. In the long run a firm in monopolistic competition when in equilibrium operates on the falling portion of AC curve and not at its lowest point. This means that there is excess capacity in the firm which implies that resources are not fully employed/ utilized.

[Ans.:C]

36. In the sequence – 50, 90, 120, 140 –output is increasing at a decreasing rate.

In the sequence – 50, 50, 50, 50 – output is not increasing

In the sequence – 50, 110, 180, 260 – output is increasing at an increasing rate.

In the sequence – 50,100, 150, 200 – output is increasing at a constant rate.

[Ans.:D]

37. Market in modern language is defined as an arrangement (and not strictly a place) which brings buyers and sellers of a commodity in contact with each other, directly or indirectly, for transacting it at a given price (and this involves bargaining).

[Ans.:D]

38. MR will be positive when TR is increasing. MR will be zero. When TR is maximum and MR becomes negative when TR starts decreasing.

[Ans.:D]

39. In the given figure AR = MR which means that the firm is a price – taker. Firms are price takers only in perfectly competitive markets. In imperfect markets they are either price makers or price searchers or price adjusters.

[Ans.:D]

40. ATC = AFC + AVC.
AS output increases, value of AFC tends to become very small and therefore AVC curve approaches the ATC curve.

[Ans.:D]

41. Market is classified in a number of ways. Based on the criterion of nature of transactions market can be either spot market or futures (forward) market. If transactions involve contracts with a promise to pay & deliver goods at some future date it is known as forward or futures market.

[Ans.:C]

42. According to TR – TC approach profits become maximum when the difference between TR & TC becomes maximum. According to MR – MC approach profits becomes maximum when MR equals MC.

If MR > MC, the firm should increase output as it is making profits.

If MR < MC, the firm should decrease output as it is making losses.

[Ans.:C]

43. An optimal firm is the one which operates at the lowest point of AC curve (i.e. is able to minimize its AC). In the long run equilibrium a monopoly firm operates at the falling portion of AC curve. This means that there is excess capacity in such market.

[Ans.:B]

44. An implicit cost is the cost of self – owned resources that an entrepreneur uses in his own business. It is not recorded in books of accounts as an entrepreneur will not entrepreneur will not pay to himself. On the other hand payment of rent, wage or interest to outsiders is known as explicit cost and is recorded in books of account.

[Ans.:A]

45. Objective of a firm is profit maximization. In case if it makes a loss it will try to minimize losses. Despite making losses it will continue to remain in business till it is able to recover all its variable costs. If it cannot do so then it should shut down or else it will end maximizing losses.

[Ans.:A]

46. Isoquant is also known as producer's indifference curve. It represent all those combinations of two factors /inputs which produce the same level of output. Isocost line on the other hand represents all those combinations of two factors that a firm is able to produce with its budget given the factor prices.

[Ans.:A]

47. Oligopoly is a market characterized by the present of few large firms selling homogeneous or differentiated products. There are substantial entry barriers in such a market on account of huge investments required, economies of scale enjoyed by the incumbents, etc.

[Ans.:A]

48. ATC = AFC + AVC

Here, FC = Rs. 400, $\therefore$ AFC = $\frac{400}{5}$ = 80

VC = 1000 at Q = 5 $\therefore$ AVC = $\frac{1000}{5}$ = 200

$\therefore$ ATC = 80 + 200 = 280

[Ans.:A]

49. Discriminating monopoly is a practice in which a firm sells the same commodity to different buyers at different prices. For this he has to segregate markets on criteria such as geography, time, uses, gender, etc.

[Ans.:D]

50. Objective of a firm is profit maximization or loss minimization. When a firm is making losses it will continue to remain in business till it is able to recovers its variable costs. In terms of equation, P = AVC. If P < AVC it should shut down the business.

[Ans.:B]