

UNIVERSITY OF SWAZILAND

DEPARTMENT OF ECONOMICS

SUPPLEMENTARY EXAMINATION 2006

TITLE OF PAPER: INTRODUCTION TO MICROECONOMICS (1 & 2) – IDE

COURSE CODE: ECON 201 – 1& 2

INSTRUCTIONS:

- 1. ANSWER QUESTION 1 AND 3 OTHER QUESTIONS**
- 2. ALL QUESTIONS CARRY 25 MARKS EACH**

TIME ALLOWED: THREE (3) HOURS

THIS PAPER IS NOT TO BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR.

QUESTION 1

- (a) Explain how the problem of price rigidities under oligopoly can be solved. [8 marks]
- (b) With the aid of a diagram, explain the decision rule of profit maximization for a firm, under perfect competition. [10 marks]
- (c) Discuss how a specific tax can be used to regulate a monopoly. In your answer, reveal the welfare effects. [7 marks]

QUESTION 2

Suppose a monopolist sold her product (output) of fat-cakes in two markets, Manzini and Siteki.

The demand curve in Siteki is given by

$$Q_S = 22.5 - 5P$$

And the demand curve in Manzini is given by

$$Q_M = 10.5 - P$$

Where Q_S = quantity demanded of fat cakes in the Siteki market

Q_M = quantity demanded of fat cakes in the Manzini market

P = price of fat cakes

Given that $MC = AC = 0.5$

- (a) Calculate the profit maximizing output and price levels in each market [12 marks]
- (b) If the monopolist does not practice discrimination, find the output and price levels that will maximize profits [7 marks]
- (c) Compare profits in the two scenarios i.e. with price discrimination and without price discrimination [4 marks]
- (d) Would you advise the monopolist to practice price discrimination? [2 marks]

QUESTION 3

Using a suitable diagram, explain the pricing rule under the kinked demand curve model. Clearly explain how this model may result in price rigidities. [25 marks]

QUESTION 4

With the aid of diagrams clearly compare pure competitive market and pure monopoly market in determining price and output levels [25 marks]

QUESTION 5

(a) Discuss the determinants of price elasticity of demand [10 marks]

(b) Given the following consumer constrained maximization problem:

$$\text{Maximize } U = X^{1/4} Y^{1/4}$$

$$\text{s.t. } 4X + 5Y = 40$$

Use the lagrangian method to:

- (i) Find the utility maximizing levels of X and Y [12 marks]
- (ii) Determine the maximum level of utility [3 marks]