

UNIVERSITY OF SWAZILAND
FACULTY OF SOCIAL SCIENCE
DEPARTMENT OF ECONOMICS
SUPPLEMENTARY EXAMINATION
JULY 2008

TITLE OF PAPER: INTERMEDIATE ECONOMIC THEORY

COURSE CODE: ECON 301

TIME ALLOWED: THREE (3) HOURS

- INSTRUCTIONS:**
- 1. ANSWER FOUR (4) QUESTIONS:
TWO (2) FROM SECTION A AND TWO
(2) FROM SECTION B**
 - 2. ALL QUESTIONS CARRY EQUAL
MARKS 25 EACH.**

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

SECTION A

QUESTION 1:

- a) Write short explanatory notes on the following consumer theory concepts:
- i) Expenditure function (3)
 - ii) Marshallian demand function (3)
 - iii) The weak versus the strong axiom of revealed preference theory (3)
- b) Consumer theory is developed in stages starting from preference theory, utility theory and demand theory. Provide a neat link of how these theories constitute the so called “consumer theory”. (10)
- c) Using the analysis in (b), show how ordinary demand functions can be obtained given a utility function $U(x_1, x_2) = x_1^2 x_2$. (6)

QUESTION 2:

Discuss the relationship that exists between total cost, marginal cost and average cost curves for a firm that is experiencing both increasing and decreasing returns to scale. (25)

QUESTION 3:

- a) Write short explanatory notes on the following microeconomic concepts:
- i) Equilibrium condition under a perfectly competitive firm (3)
 - ii) A comparison between perfect competition and monopoly (3)
 - iii) Bertrand equilibrium (3)
- b) Suppose that the Swaziland Water Services practices price discrimination between industrial demand for water and the household demand for water. The demand for industrial water is given by the function $Q_i = 1200 - 10P_i$ and the demand for household water is represented by $Q_h = 800 - 10P_h$. Total costs are: $TC = 50Q + 10,000$
- i) What will be the output level for each market? (4)
 - i) What will be the price levels for both markets? (4)
 - ii) Calculate the profits for both markets. (4)

QUESTION 4

a) Write short explanatory notes on the following general equilibrium concepts:

- i) General equilibrium (3)
- ii) A pareto efficient allocation (3)
- iii) Walras law (3)

b) Argue the case why a “contract curve” in a standard two – person two - commodity pure exchange economy represents “pareto efficient” allocations. (16)

SECTION B

QUESTION 5

Write short explanatory notes on the following:

- i) Balance of payments (5)
- ii) Net exports (5)
- iii) Differentiate between fixed exchange rate and flexible exchange rate (5)
- iv) Gross domestic product (5)
- iv) Unemployment (5)

QUESTION 6

a) Write short explanatory note on the following:

- i) Progressive income tax (5)
- ii) Balanced budget multiplier (5)

b) If $C = 40 + 0.8 Y_d$; $Y_d = Y - T$; $I = 60$; $G = 20$ and $T = 20$
Calculate:

- i) The equilibrium level of income. (5)
- ii) The new equilibrium level of income if investment falls by E10 and as a result of a falling income level unemployment insurance increases to E5. (5)
- iii) Given the level of income in ii), what change in government spending is needed to bring the income level back to its original position (as in i)? (5)

QUESTION 7

- a) Distinguish between monetary policy and fiscal policy. (5)
- b) Discuss the effectiveness of a fiscal policy in an extreme case of a vertical LM curve and the effectiveness of monetary policy in an extreme case of a horizontal LM curve. (20)

QUESTION 8

- a) Write short explanatory notes on the following:
- i) Aggregate supply curve (5)
 - ii) Bargained real wage (5)
- b) A hypothetical economy is described by the following :
A mark-up(μ) equals 0.25; a wage curve of $W/P^e = 1 - 2.5\mu$ and a labor force of 100 workers. Given that the production function is defined by $Y = N$ and expected inflation defined by $P^e = P_{-1}$
- i) Calculate the price that firms will set when the wage is E5 per worker. (5)
 - ii) Calculate the price – real wage the workers receive. (5)
 - iii) Determine the rate of unemployment. (5)