

possibilities frontier (PPF), which is a curve that shows the maximum possible output combinations of two goods or services that an economy can produce given its resources and technology. The opportunity cost of producing more of one good is the amount of the other good that has to be given up, which is equal to the slope of the PPF. Opportunity cost is relevant for economic decision making because it helps us to evaluate the trade-offs involved in any choice and to allocate our scarce resources efficiently.

Question 3: Suppose the demand function for a good is $Q_d = 100 - 2P$ and the supply function is $Q_s = 50 + P$, where Q is quantity and P is price. Find the equilibrium price and quantity in this market. What happens to the equilibrium price and quantity if there is an increase in demand to $Q_d = 120 - 2P$? Use algebra and graphs to support your answer. (15 marks)

Answer: To find the equilibrium price and quantity, we need to set $Q_d = Q_s$ and solve for P :

$$100 - 2P = 50 + P$$

$$3P = 50$$

$$P = 50/3$$

Substituting $P = 50/3$ into either Q_d or Q_s , we get:

$$Q = 100 - 2(50/3) = 100/3$$

Therefore, the equilibrium price and quantity are $P^* = 50/3$ and $Q^* = 100/3$.

3. The demand curve for a good is downward sloping because of the substitution effect and the income effect.

* True

* False

* Answer: (True)

4. The supply curve for a good is upward sloping because of the increasing marginal cost of production.

* True

* False

* Answer: (True)

5. A perfectly competitive market is characterized by all of the following except:

* There are many buyers and sellers.

* The goods sold are homogeneous.

* There is free entry and exit of firms.

* Firms have market power.

* Answer: (d) Firms have market power.

****Section B: Short Answer Questions (4 x 5 marks)****

6. Define the term "consumer surplus" and explain how it is measured.

Consumer surplus is the difference between the maximum price a consumer is willing to pay for a good and the actual price paid. It is measured by the area below the demand curve and above the price line.

KEYWORDS:

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