

UNIVERSITY OF FORT HARE
DEPARTMENT OF ECONOMICS

ALICE AND EAST LONDON CAMPUSES

ECO 211/ ECO 211E

JUNE EXAMINATION 2025

Time: 3 Hours

Subject: Economics 2 – Microeconomics

Marks:100

This paper consists of 8 pages, including the cover page.

Internal Examiner:

Dr D Hompashe
Dr M Tendererei
Ms NG Ndlovu

Internal Moderator:

Dr D Hunter

INSTRUCTIONS

Answer ALL Three (3) Sections

Answer ALL Questions in Section A

Answer ALL Questions in Sections B

Answer TWO Questions in Section C

SECTION A

[25 Marks]

Multiple Choice Questions – Compulsory

Instruction: Indicate the most correct answer on the Answer Booklet provided

Question 1

1. Decisions are made in either the short run or the long run. In economics, the short run is a period
 - a. of less than one year.
 - b. between one year and five years.
 - c. of time in which something about the firm's production process cannot be changed.
 - d. in which the firm can vary any of its inputs.

2. When the marginal product of a variable input is greater than the average product of that input, we know that
 - a. total product is constant.
 - b. average product is rising.
 - c. marginal product is rising.
 - d. average product is falling.

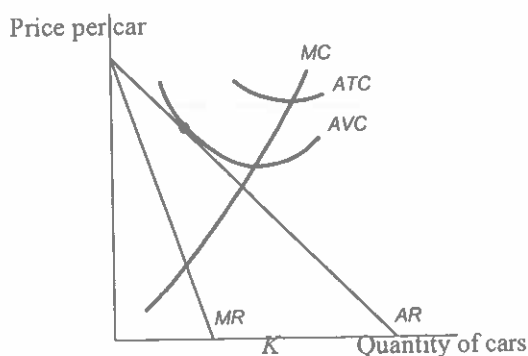
3. A fixed input is an input
 - a. whose quantity can be changed in the short run but not in the long run.
 - b. whose quantity can be changed in the short run or in the long run.
 - c. whose quantity cannot be changed in the short run.
 - d. restored to sound condition after damage or injury.

4. An isoquant is a
 - a. curve showing all possible combinations of market baskets that provide equal satisfaction of the consumer.
 - b. curve showing all possible (efficient) combinations of inputs that result in an equal output for the firm.
 - c. ray from the origin that describes all input combinations for which the capital-labour ratio is constant.
 - d. line along which the total cost of the firm is constant.

5. The supply curves of resources in a constant-cost industry are
 - a. perfectly inelastic.
 - b. perfectly elastic.
 - c. relatively elastic.
 - d. relatively inelastic.

6. In the case if an increasing-cost industry, which of the following statements applies?
 - i. Expansion of the industry results in an increase in the cost of established firms.
 - ii. Output is increased by increasing the number of firms producing at least the same number of units produced by established firms.
 - iii. Increases in output require increases in the price of the product.
 - a. (i) only
 - b. (i) and (ii)
 - c. (ii) and (iii)
 - d. (i) and (iii)

- e. (i), (ii), and (iii)
7. The expansion of the overnight mail delivery industry causes an improvement in transportation, so reducing charges to each firm in that industry. This is an example of
- economies of scale.
 - decreasing returns to scale.
 - increasing returns to scale.
 - a decreasing-cost industry.
8. Monopoly is an industry in which there is/are
- a single buyer.
 - many sellers.
 - free entry and exit.
 - a single seller.
9. if General Motors sells cars, as shown in the diagram below, it



- will earn positive economic profits.
 - will break even.
 - will suffer a loss equal to its fixed costs.
 - will suffer a loss equal to its variable costs.
10. The important difference between the characteristics of perfectly competitive and monopolistically competitive markets is that firms in monopolistically competitive industries
- have a downward sloping and relatively inelastic demand (as compared to market demand.)
 - do not try to maximize profits by producing where $MR = MC$.
 - sell similar but not identical products.
 - have substantial barriers to deter the entry of competing firms while perfectly competitive firms do not.
11. The long-run equilibrium price charged by the monopolist competitor is likely to
- be lower than the perfect competitor's price.
 - equal long-run marginal cost.
 - exceed long-run average cost so that all firms are earning positive economic profits.
 - lie somewhere between the perfect competitor's price and the monopolist's price.
12. Which of the following does not characterise monopolistic competition?
- Product differentiation.
 - Many producers.
 - Absence of advertising.
 - Some control over price.

- e. None of the above characterise monopolistic competition.
13. From an efficiency viewpoint, one positive aspect of advertising is that it
- may increase the monopoly power of the producer.
 - increases consumer loyalty.
 - increases information to the consumer.
 - provides employment for advertising majors.
14. In the long run, a perfectly competitive firm earns:
- Positive economic profits
 - Negative economic profits
 - Zero economic profits
 - Accounting profits only
15. Which of the following is *not* a characteristic of a perfectly competitive market?
- Many buyers and sellers
 - Homogeneous products
 - Firms are price makers
 - Free entry and exit
16. The most frequently cited reason for increasing returns to scale is
- lower input prices.
 - indivisibility of inputs.
 - larger fixed costs with a larger plant size.
 - the difficulty of managing a huge enterprise.
17. A firm earning a normal profit
- should discontinue production.
 - is making less than it could make with its resources in other industries.
 - is covering all its variable costs but none of its fixed costs.
 - is making no more than it could make with its resources in other industries.
18. Suppose gold were discovered on Mount Hopeful. The initial firm earned significant economic profits and hundreds of mines were opened. As the industry expanded, transportation shifted from donkey to electric train and transportation costs per pound fell dramatically. This is an example of a(n)
- constant-cost industry.
 - increasing returns to the variable factor.
 - decreasing-cost industry.
 - diseconomies of scale.
19. A natural monopoly is characterized by
- decreasing returns to scale.
 - patent protection of certain basic processes.
 - the firm's having exclusive control over a basic input.
 - a decreasing long-run average cost curve over the feasible range of output.
20. Since entry is barred in a monopoly, in the long run the monopolist will
- do nothing, since entry will not force an adjustment.
 - adjust output but leave the price at the short-run profit-maximizing level.
 - adjust price but leave the output at the short-run profit-maximizing level.

- d. adjust both price and output levels to reflect long- run scale of plant adjustments.
21. Price discrimination is
- illegal.
 - a technique that can improve the firm's revenue and profit performance.
 - immoral in most cases.
 - impossible if consumers have perfect information.
22. A regulatory authority can require a monopoly to set price equal to
- the average cost of production.
 - the marginal cost of production and the average cost of production at the same time.
 - the average cost of production or the marginal cost of production, but not both.
 - marginal revenue.
23. Unlike a perfectly competitive firm, a monopolistically competitive firm
- faces a downward-sloping demand curve.
 - can change the characteristics of its product.
 - can vary the price of its product.
 - all of the above.
24. The market for eyeglasses provides a good example of
- perfect competition.
 - monopolistic competition.
 - pure oligopoly.
 - differentiated oligopoly.
25. A monopoly's supply curve is
- the horizontal summation of its SRMC curves.
 - upward-sloping except in the case of a Giffen good, in which case it is negatively sloped.
 - the same as the market supply curve since the monopoly is the industry.
 - none of the above.

SECTION B

[Total 25 marks]

(Answer ALL questions)

Question 2

- a) Illustrate diagrammatically and explain how the Engel curve for an inferior good and a Backward Bending Engel Curve is derived from a two-good consumer equilibrium diagram. (13)
- b) Assume that Good X is an Inferior good, illustrate and explain the income and substitution effects for an increase in the price of good X according to the Slutsky's real income approach. (12)

SECTION C

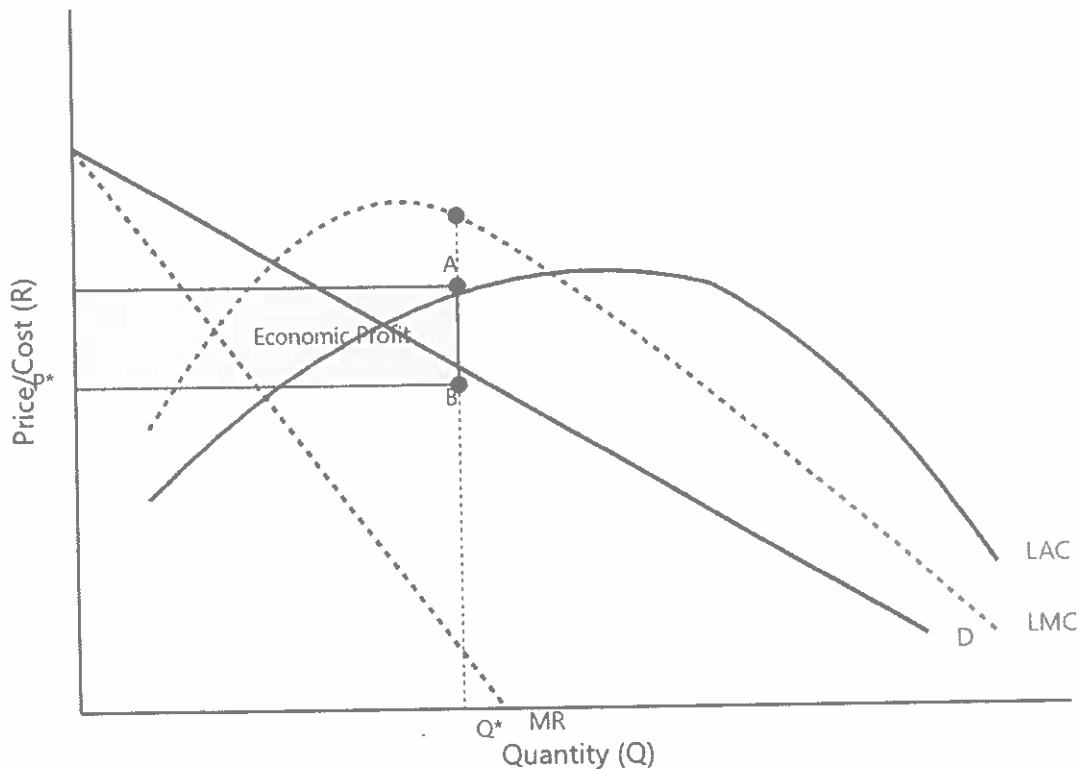
[Total 50 marks]

CHOOSE ONLY TWO QUESTIONS

Question 3

Eskom is the sole provider of electricity services in the country. The government has granted Eskom exclusive rights to operate in this industry for the foreseeable future due to its significant research and development investments.

Below is a diagram representing Eskom's economic situation as a monopolist in the long run:



Based on the diagram above, answer the following questions:

- a) Explain what makes Eskom a monopoly and identify FOUR key characteristics of monopoly markets. (5 marks)
- b) Identify the profit-maximizing quantity (Q^*) and price (P^*) for Eskom. (2 marks)
- c) Explain the economic reasoning behind the monopolist's choice of this output level. (3 marks)
- d) The shaded area in the diagram represents Eskom's economic profit.
 - 1) Calculate the economic profit using the appropriate formula and the information from the diagram. (3 marks)
 - 2) Explain why a monopolist like Eskom can earn economic profits in the long run, unlike firms in perfect competition. (3 marks)
- e) Suppose the government is concerned about Eskom's monopoly power and is considering regulation.
 - 1) Explain how implementing a price ceiling at the level where $P = LAC$ would affect Eskom's output, price, and economic profit. Illustrate your answer using the diagram. (4 marks)
 - 2) Discuss TWO other regulatory approaches the government could use to address monopoly power and evaluate their potential effectiveness. (5 marks)

[25 marks]

Question 4

- a) Consider a two-good, two-person exchange situation. There is one (perfectly divisible) unit of each of two goods, food (F) and clothing (C). There are two consumers, Ann and Betty, denoting their consumption quantities. Draw an Edgeworth box that shows Pareto Efficient Allocation from this information. (10)
- b) Using a diagram, explain how a monopoly determines its profit-maximizing level of output and price. Compare this to the outcome in a perfectly competitive market, and illustrate the welfare loss (deadweight loss) that arises due to monopoly power. (15)

[25 marks]

Question 5

- a) Using appropriate diagrams, illustrate and explain how equilibrium is reached in an increasing-cost industry in the long run.
In your answer, discuss how diseconomies of scale in one or more inputs of production contribute to the upward-sloping long-run industry supply curve and rising costs. (12)
- b) Illustrate and discuss why a perfectly competitive firm can make economic profits in the short run, but not the long run. (13)

[25 marks]