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[20%]

- ***Analysis concentrates on how the equilibrium price is likely to change in response to some change in the economic environment: this is the method of comparative statics***
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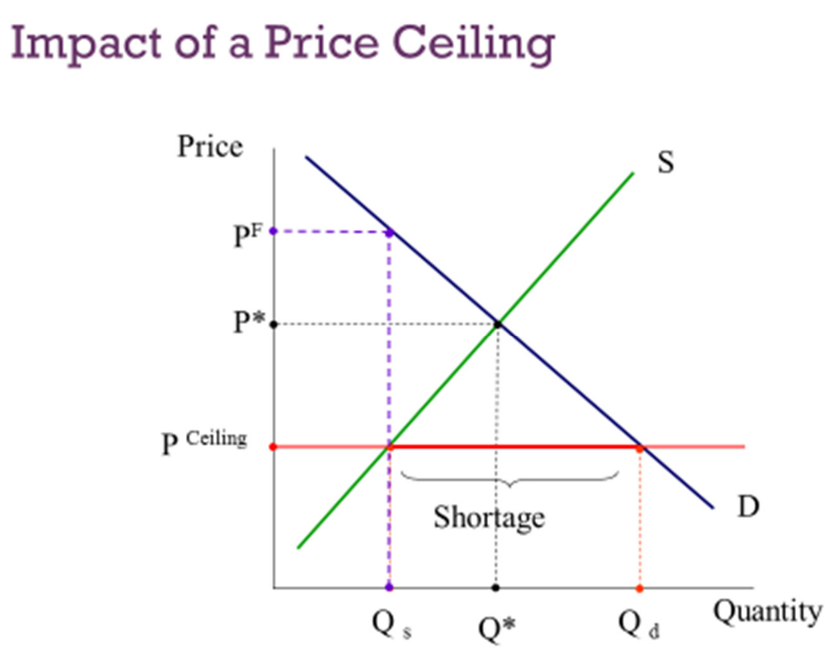

The result is a shortage of (Qd – Qs) units, requiring some form of rationing

(b) An important part of economic decision making is the *marginal principle*. Explain this principle and illustrate by means of appropriate diagram and equations the profit maximization condition for a firm.
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- ***Control Variable Examples:***
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Slope (calculus derivative) of the total benefit curve. $MV = \Delta B / \Delta Q$

The marginal principle relates to making decisions where a firm maximizes profit, and this would occur when the Marginal cost is equal to Marginal revenue. The rationale for this is to identify the quantity that would satisfy this condition, and therefore the firm would ensure that it is not producing more or less than is required to achieve maximum profit.

(c) Game Theory can be defined in the context of the strategic interaction amongst different economic decision-makers. Explain in details the concept of the *Nash Equilibrium* and provide an example that represents it. [25%]

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e.g. Prisoners' Dilemma: Two ex-convicts are arrested by police on suspicion of carrying out a spate of burglaries in a particular neighbourhood. The police lack the evidence to charge the pair with the burglaries immediately, so instead hold them in separate cells and offer each the chance to confess to the crimes in return for a reduced sentence.

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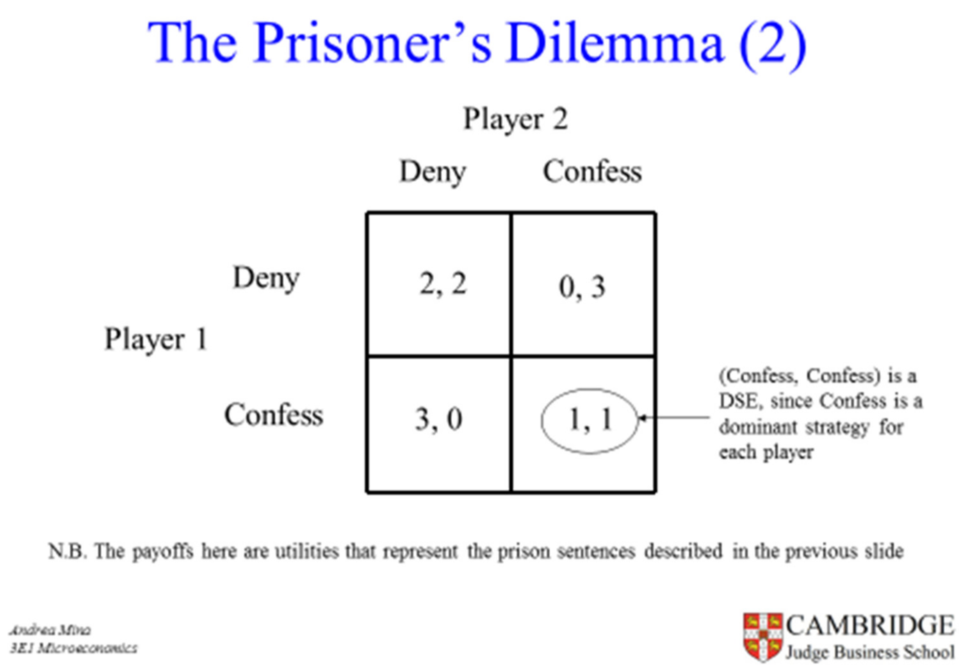

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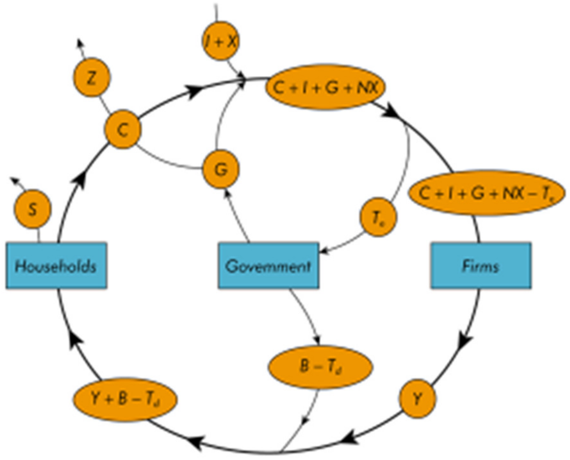
The Circular Flow



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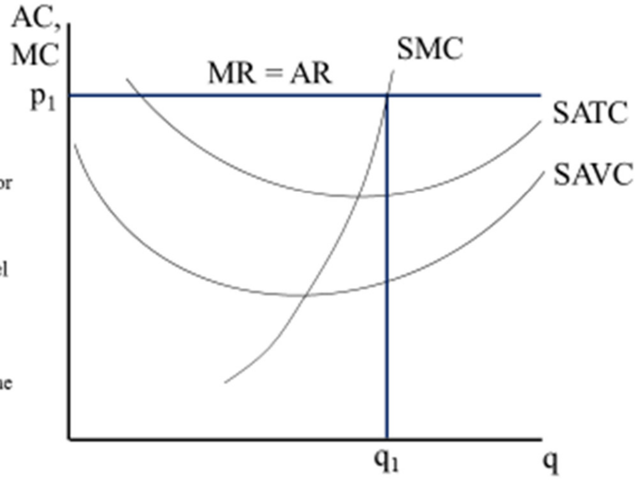
Perfect Competition in the Short Run: The Supply Curve of the Firm (1)

- Assume a typical U-shaped set of (short-run) cost curves
- Now suppose that the prevailing market price for the firm's output is p_1
- Its profit maximising level of output is q_1
- By considering different prices we can construct the firm's supply curve…



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MS3 Economics of Firms and Markets

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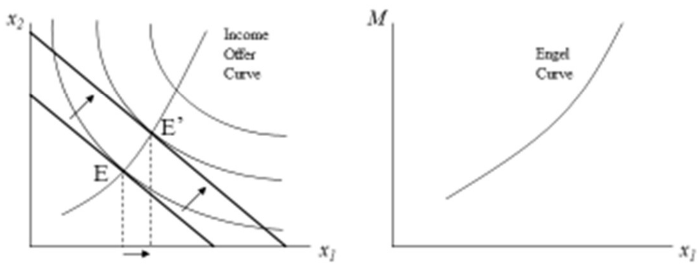
(b) What is an 'inferior good'? Illustrate your definition by means of an appropriate diagram. [20%]

Normal and Inferior Goods (1)

- For a 'Normal' good, quantity demanded increases (decreases) with a rise (fall) in income



x_1 is a normal good in this case (as is x_2)

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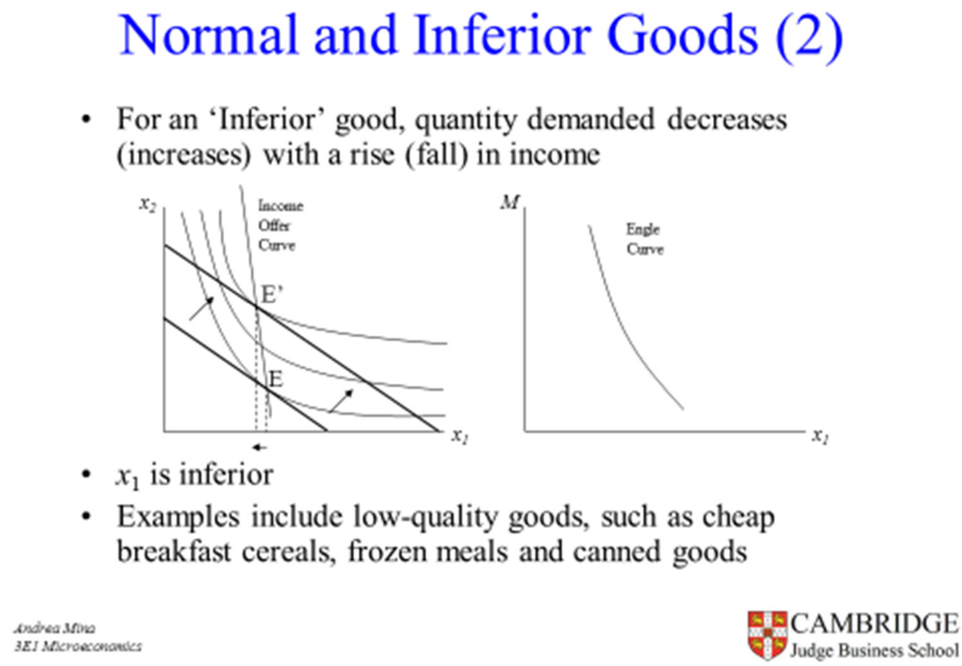

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- ***Dominant strategies are interesting because they are closely connected to economists usual assumption that people are rational***
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(d) Identify and discuss the advantages and disadvantages of having a single currency in a trading block. Use the Euro as an example. [30%]

The answers can include the following points.

- ***The euro is now the single currency of the European Union. Twelve of the then 15 countries adopted it for non-cash transactions from 1999 and for all payments in 2002 when euro notes and coins were issued.***
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3 (a) what are the common features of an oligopolistic market? Explain the different models of Oligopoly. [25%]

- ***Common features of oligopolistic markets:***
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The models can then be briefly discussed with diagrams.

(b) Explain the '*Pareto criterion*' and illustrate it by means of an appropriate diagram that describes the concept of an efficient goods allocation and the impact on utility of individuals. [25%]

- ***We define a resource allocation as a complete description of who does what, and who gets what, within an economy***
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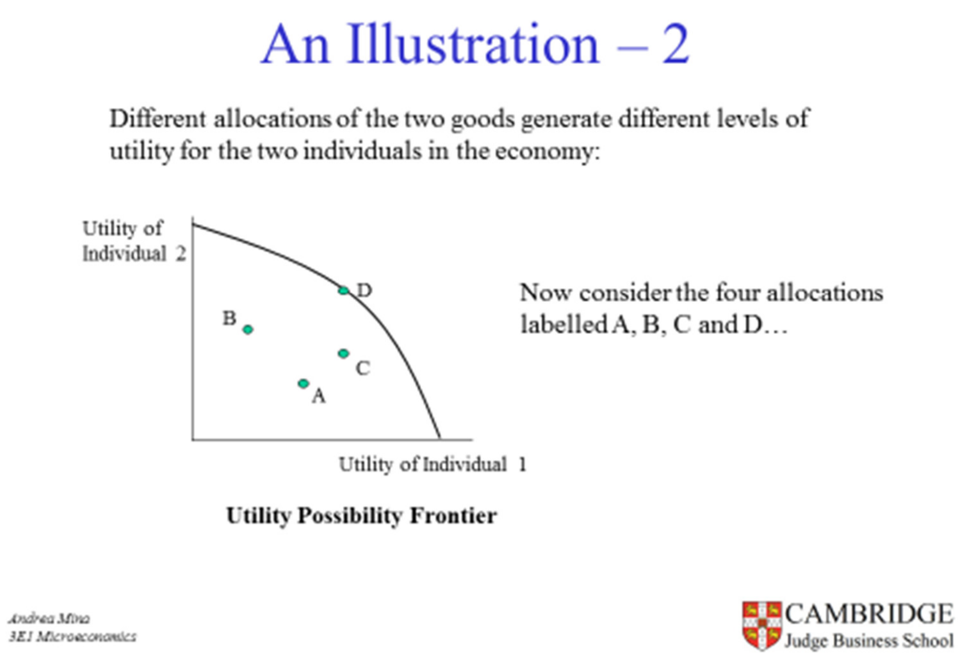
Consider a simple two person, two good economy. Resource and technology constraints limit the amount of the two goods that can feasibly be produced:



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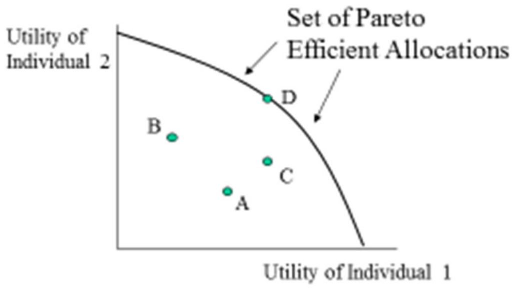

Utility Possibility Frontier

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(c) Explain in details the simple economy model developed by J.M. Keynes, and illustrate by means of appropriate diagrams how equilibrium income is achieved. Explain why the change in national income is greater than the amount of government spending. [25%]

Components of aggregate demand:

C = consumer demand for g & s

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G = government demand for g & s

(closed economy: no ***NX***)

- **Disposable income** is total income minus total taxes: $\boldsymbol{Y - T}$.
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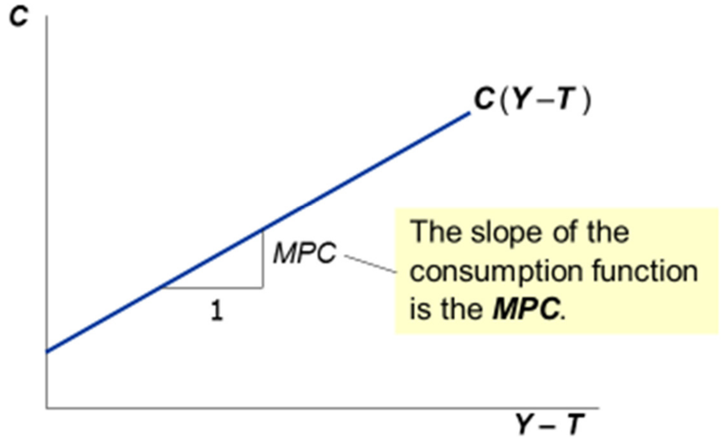

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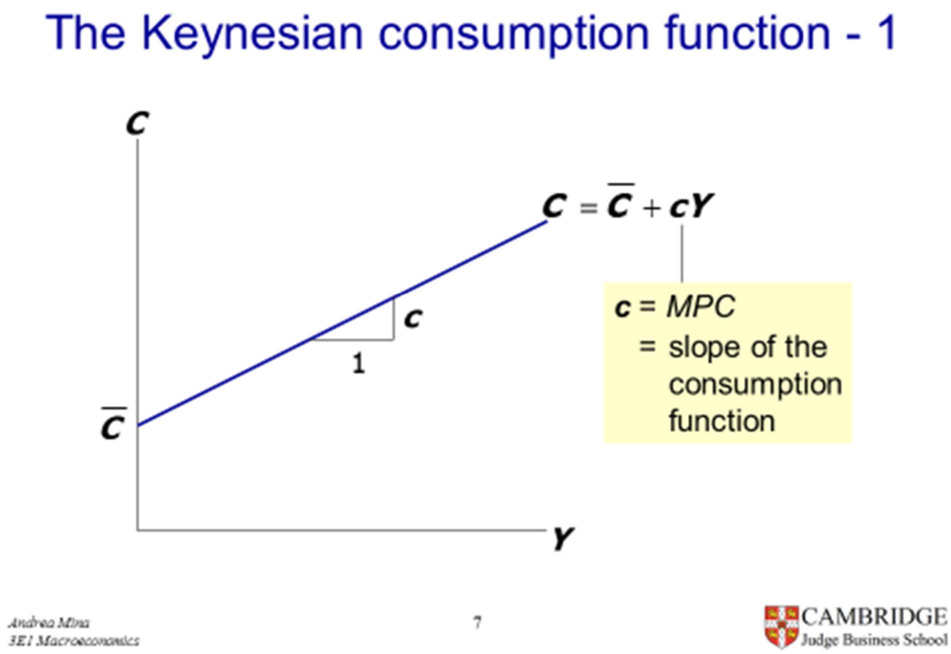

(d) Explain three different measures that the government can introduce to increase exports. Discuss the relative advantages and disadvantages. [25%]

This can be an open question which can include using different policies from 1)-joining a single market, 2)- increasing industry competitiveness and productivity, 3)-devaluation of the currency. They all have their advantages and disadvantages:

1)- Advantages: have a large single market, the freedom of movements of goods, services, capital, and people. Reduce uncertainty to businesses in terms of costs and pricing, better business planning…etc. Disadvantages: countries disagreeing on issues, bureaucracy, legislations, political disagreements….etc.

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3)- Advantages: increases export by making the exported product or service cheaper to others, it is a faster way of achieving exports…etc. Disadvantages: intervention in market forces, makes import expensive, loss of confident of the financial market.

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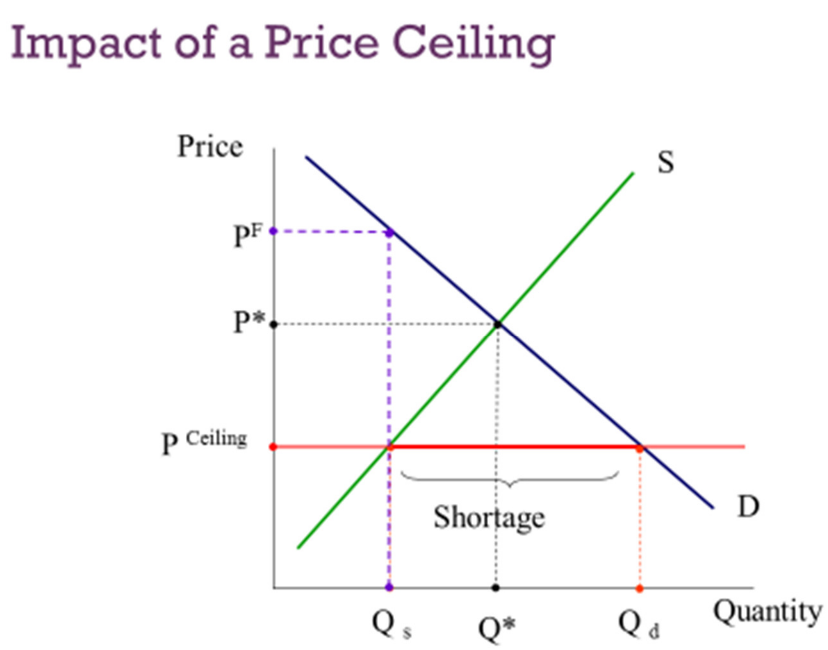

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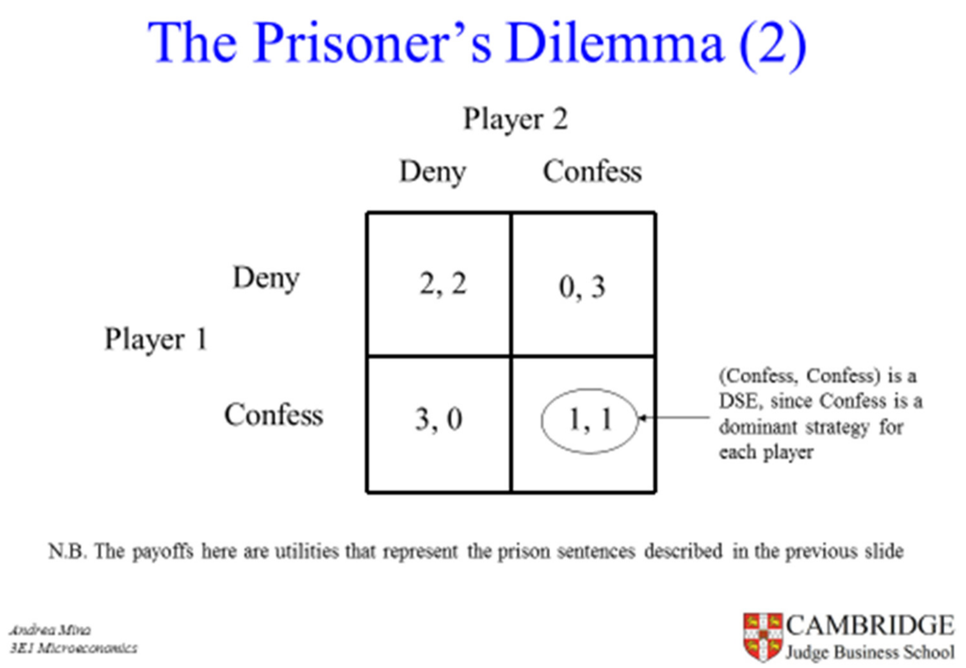

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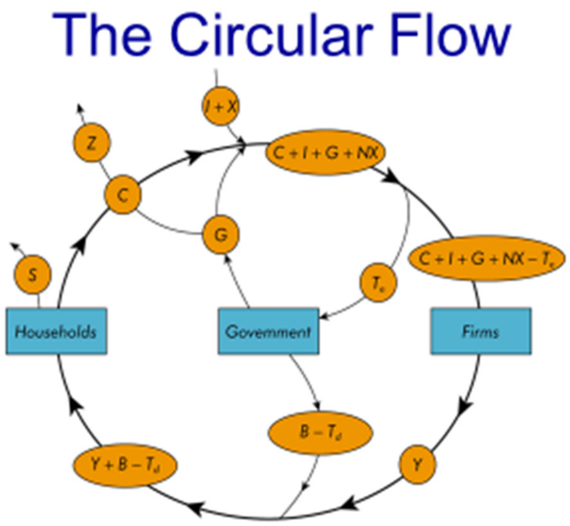

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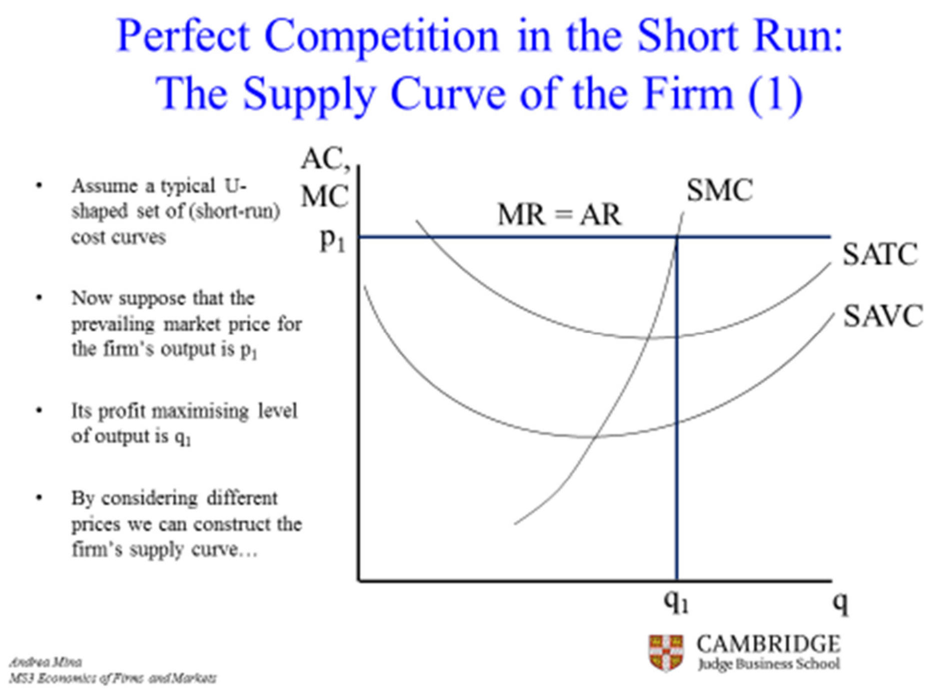

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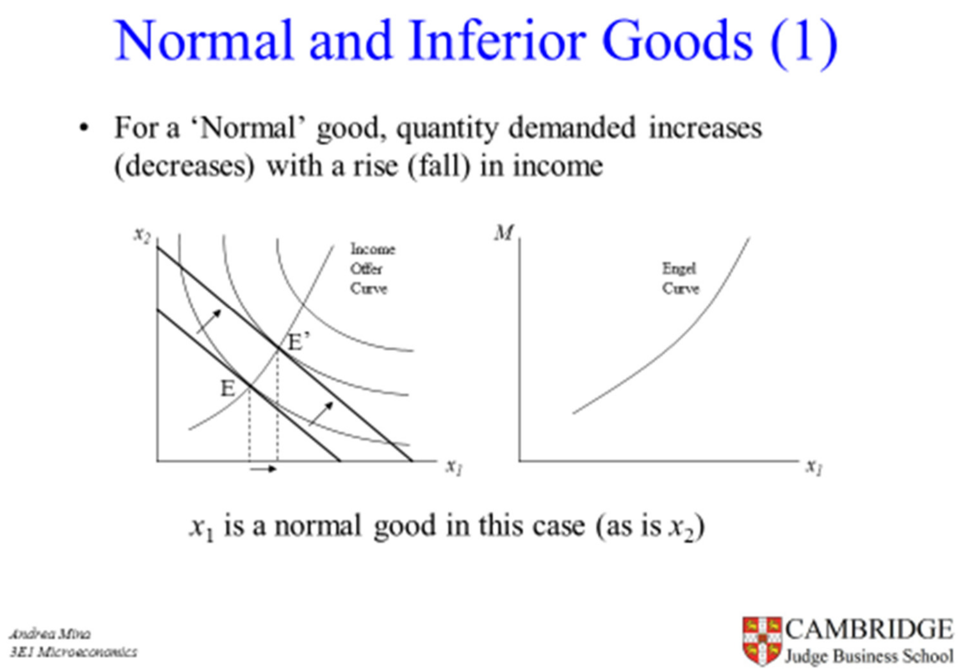

Normal and Inferior Goods (2)

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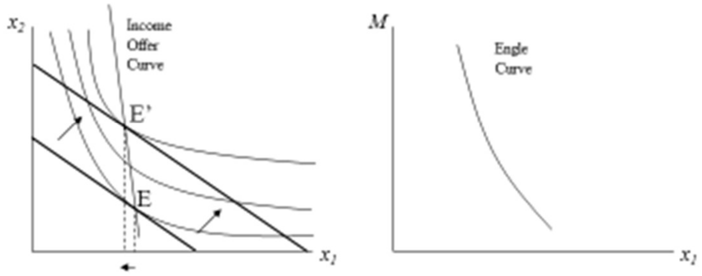

- x_1 is inferior
- Examples include low-quality goods, such as cheap breakfast cereals, frozen meals and canned goods

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3E1 Microeconomics

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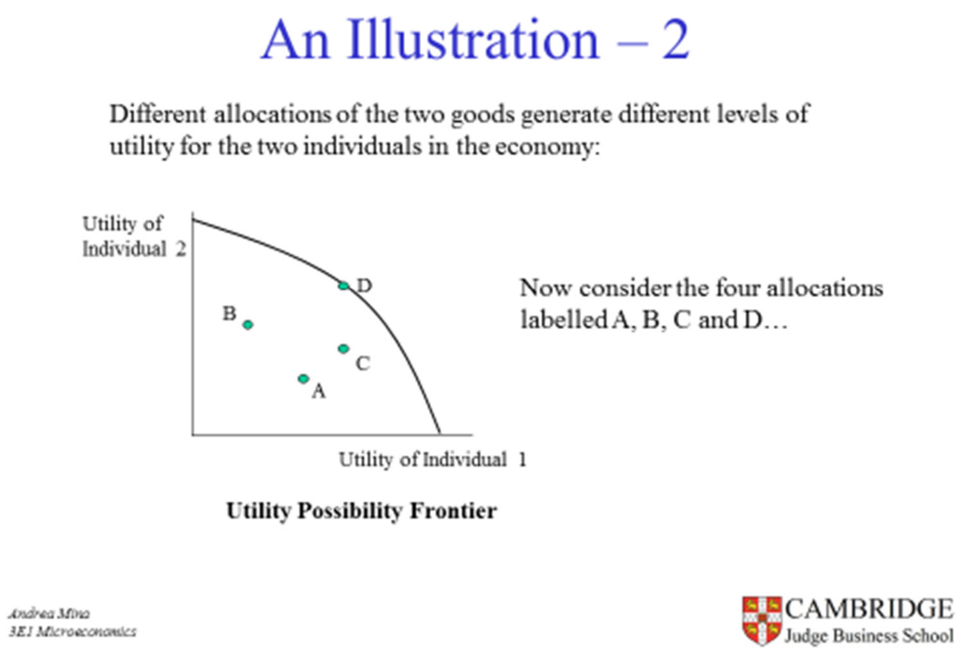

An Illustration – 3

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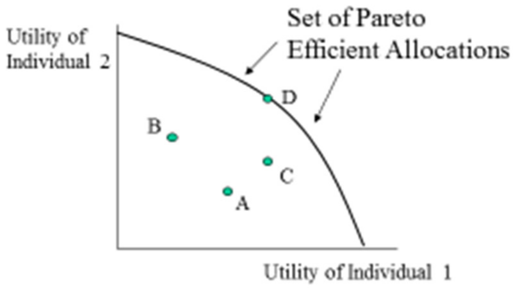

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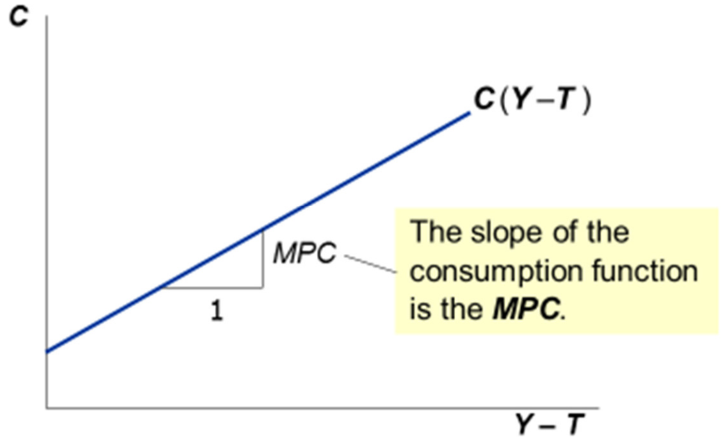

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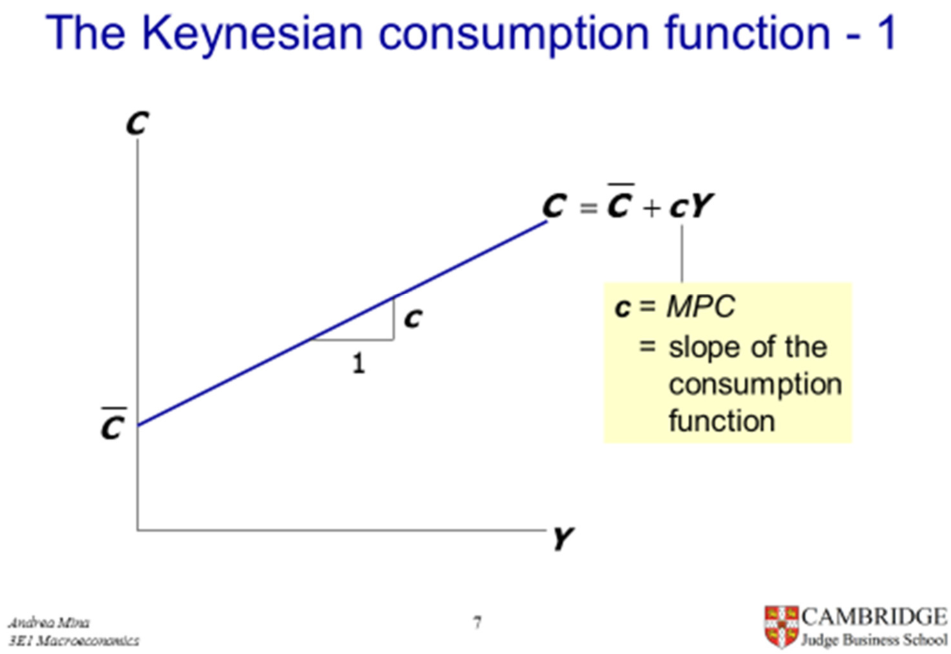
   (*APC* = *C/Y*)
3. Income is the main determinant of consumption.



(d) Explain three different measures that the government can introduce to increase exports. Discuss the relative advantages and disadvantages. [25%]

This can be an open question which can include using different policies from 1)-joining a single market, 2)- increasing industry competitiveness and productivity, 3)-devaluation of the currency. They all have their advantages and disadvantages:

1)- Advantages: have a large single market, the freedom of movements of goods, services, capital, and people. Reduce uncertainty to businesses in terms of costs and pricing, better business planning…etc. Disadvantages: countries disagreeing on issues, bureaucracy, legislations, political disagreements….etc.

2)- Advantages: encourages production, cost management and control, increase employment, cut inefficiencies. Disadvantages: government intervention in market forces, possible claims of unfair competition, cost to government…etc.

3)- Advantages: increases export by making the exported product or service cheaper to others, it is a faster way of achieving exports…etc. Disadvantages: intervention in market forces, makes import expensive, loss of confident of the financial market.