

ENGINEERING TRIPOS PART IIA

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Monday 28 April 2008 2.30 to 4.

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Module 3E1

BUSINESS ECONOMICS

*Answer not more than two questions.*

*All questions carry the same number of marks.*

*The **approximate** percentage of marks allocated to each part of a question is indicated in the right margin.*

*There are no attachments.*

STATIONERY REQUIREMENTS

Single-sided script paper

SPECIAL REQUIREMENTS

None

**You may not start to read the questions printed on the subsequent pages of this question paper until instructed that you may do so by the Invigilator**

- 1 (a) What do economists mean by the term *public good*? [15%]
- (b) Why do public goods result in market failure? [35%]
- (c) Outline the key features of the neoclassical endogenous model of economic growth. [35%]
- (d) What are the implications of the neoclassical endogenous model of economic growth for government policy? [15%]
- 2 (a) What are the *axioms of choice* and what role do they play in the rational agent model of the consumer? [25%]
- (b) 'A Pareto efficient allocation is Pareto superior to all Pareto inefficient allocations'. Is this statement true or false? Explain your answer. [25%]
- (c) Explain the life cycle hypothesis of consumption. [25%]
- (d) Outline two potential weaknesses of the life cycle hypothesis. [15%]
- (e) Assuming that the life cycle hypothesis is correct, describe the impact of a temporary increase in income tax on the level of consumption. [10%]
- 3 (a) Briefly explain the distinction between *total*, *average* and *marginal* costs for a firm. [10%]
- (b) 'A firm should cease production in the short-run when its losses exceed its fixed costs'. Is this statement true or false? Explain your answer. [25%]
- (c) Using a suitable diagram, explain what economists mean by the term *natural monopoly*. [25%]
- (d) Discuss the potential advantages and potential disadvantages of a single European currency. [40%]

- 4 (a) Briefly explain what is meant by *game theory*. [20%]
- (b) Carefully explain the dilemma that the two players of a Prisoners' Dilemma game face. Why is this game of interest to economists? [40%]
- (c) Explain how the concept of comparative advantage shows that there may be welfare gains through international trade. [20%]
- (d) Explain the concept of the law of one price. Why may it not apply in practice? [20%]

**END OF PAPER**

