ENGINEERING TRIPOS   PART IIA

Monday 3 May 2010   2.30 to 4

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   SPECIAL REQUIREMENTS
Single-sided script paper   CUED approved calculator allowed

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

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Version: Final

1   (a)   Explain the meaning of each of the following terms in relation to a firm:

       (i)   Increasing returns to scale   [10%]

      (ii)   Minimum efficient scale   [10%]

   (b)   Define the marginal rate of technical substitution of labour for capital and explain why it is equal to the factor price ratio when a firm is in equilibrium.   [25%]

   (c)   Explain the difficulties of using fiscal policy for short-term demand management of the economy.   [25%]

   (d)   Explain why the Government Budget Deficit is not necessarily a good indicator of the government's fiscal stance.   [15%]

   (e)   In the context of the simple Keynesian Cross model, explain why a balanced budget is stimulatory.   [15%]

2   (a)   Briefly enumerate and explain what you see as the main causes of the recent financial crisis.   [30%]

   (b)   Briefly explain the logic of how each of the following policy measures were meant to help alleviate the crisis in the UK:

      (i)   interest rate reductions;   [10%]

     (ii)   the reduction in the rate of VAT;   [10%]

    (iii)   quantitative easing;   [10%]

    (iv)   the partial nationalization of the banks.   [10%]

   (c)   Bill and Jenny are talking about how much they like going to the gym and how much they like eating out at their favourite restaurant. A session at the gym costs the same as a meal at the restaurant. Bill says that, for his current consumption of gym sessions and restaurant meals, he values one more meal twice as much as he values one more session at

the gym. Jenny tells him that he cannot be choosing his optimal consumption bundle. Is Jenny right? Why or why not? [30%]

3 (a) Being careful to explain your reasoning, determine the solution (if one exists) to the following game using the method of iterative deletion of strictly dominated strategies:

		Player 2		
		L	C	R
	T	(2, 0)	(1, 1)	(4, 2)
Player 1	M	(1, 4)	(1, 2)	(2, 3)
	B	(1, 3)	(0, 2)	(3, 0)

Payoffs are shown as (player 1, player 2) [15%]

(b) 'If a player has a strictly dominant strategy in a simultaneous-move game, then she is sure to get her best outcome.' Is this statement true or false? Explain your reasoning and give an example of a game that illustrates your answer. [30%]

(c) Explain the difference between fixed and floating exchange rates. [15%]

(d) Explain why monetary policy is unlikely to be effective under fixed exchange rates. [10%]

(e) Briefly explain the theory of comparative advantage and then state and evaluate some of the arguments that have been made to the effect that it is nevertheless sometimes necessary to implement protectionist trade policies. [30%]

Version: Final   (TURN OVER

4   (a)   Explain the meaning of the term externality and explain why externality problems are sometimes referred to as problems of "missing markets". [20%]

      (b)   Explain the process by which direct bargaining between perpetrators and victims of a negative externality can secure a Pareto improvement. [40%]

      (c)   From the perspective of the UK, outline the potential pros and cons of adopting the Euro. [40%]

END OF PAPER