**School of Management and Social Sciences (Dept. of Business Administration)**

**Mid term-Summer Semester 2020**

**Course Code: ECO 116 Course Title: Microeconomics/Intr.to economic**

**Instructor: Ms. Wajiha Amin**

**Total Marks: 30**

**Attempt all questions.**

**Q1: (a) Discuss briefly the concept of opportunity cost in Economics.**

Opportunity cost is the best alternative that we forgo, or give up, when we make a choice or a decision. Opportunity costs represent the benefits one misses out on when choosing one alternative over another. An example of an Opportunity Cost is, you spend time and money going to watch a movie, you cannot spend that time at home reading a book, and you can't spend the money on something else.

**For each of the following, what can be the potential opportunity cost.**

**• Studying for your exam**

The opportunity cost is the time spent on studying for an exam could have been time spent working and earning money, so the cost is the time.

**• Spending 2 hrs playing computer games instead of doing exercise.**

The opportunity cost here is the 2 hours spent playing computer games could have been time spent at the gym doing exercise, so the cost is your health.

**• Going to a university instead of staying at home**

The opportunity cost here is going to university and spending money on education while you could have stayed home and spent that money on food instead

**• You decide to spend $80 on some great shoes and do not pay your electric bill.**

The opportunity cost here is the $80 you spend on shoes could have been spent on electricity bill, therefore your electricity is the opportunity cost you forgo.

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**(b) Differentiate between positive and normative economics and identify each of the following statement as positive or normative.**

Positive economics is concerned with the development and testing of positive statements about the world that are objective and verifiable, it describes and explains various economic phenomena or the "what is" scenario. Normative statements derive from an opinion or a point of view and focuses on the value of economic fairness, or what the economy "should be" or "ought to be." While positive economics is based on fact and cannot be approved or disapproved, normative economics is based on value judgments.

**• There is an inverse relationship between wealth and demand for inferior goods.**

Positive Economics

**• Wealth tax should be implemented to reduce the disproportionate distribution of wealth.**

Normative Economics

**• Adopting protectionist policies results in shrinkage of the total global gross domestic product.**

Positive Economics

**• An increase in tax rate ultimately decreases total tax revenue.**

Positive Economics

**• Tariffs should be increased on imports from countries with poor human rights record.**

Normative Economics

**• Developing countries should adopt democracy as a system only when they population is educated and emancipated.**

Normative Economics

**Q2: (a) consider the following diagram and explain it in few points by stating the respective law.**

These 2 graphs show Total Utility and Marginal Utility.

Total Utility is the total satisfaction that a person gets from the consumption of goods and services which is shown in the first graph, the person’s satisfaction is rising as every unit increases and is at its highest at the 6th Unit, after that it starts to decrease.

Marginal Utility is the additional to utility as a result of consuming on more units of the same good or services which is shown in the second graph. Marginal Utility is calculated by dividing the change in total utility with the change in total quantity. MU = ∆ TU / ∆ Q

**(b) What the concept of diminishing marginal rate of substitution is all about?**

The Diminishing Marginal Rate of substitution concept refers to a consumer's willingness to part with less quantity of one good in order to get one more additional unit of another good. It is abbreviated to DMRS.

**(c) Give any 2 characteristics of IC.**

IC refers to Indifference Curve. An indifference curve represents all the possible combinations of two goods which will give the same level of satisfaction.

Two characteristics of Indifference Curves are:

* Indifference curves slope downward to the right
* Indifference curve will not touch the axis

**Q3: (a) Differentiate between**

**• Cardinal and ordinal approach**

Cardinal approach is the utility wherein the satisfaction derived by the consumers from the consumption of good or service can be measured numerically. The cardinal utility theory says that utility is measurable and by placing a number of alternatives so that the utility can be added.

Ordinal approach states that the satisfaction which a consumer derives from the consumption of product or service cannot be measured numerically. The ordinal utility theory says that utility is not measurable but it can be compared.

**• Marginal utility and total utility**

Total utility is the total satisfaction received from consuming a given total quantity of a good or service, while marginal utility is the satisfaction gained from consuming an additional quantity of that item.1

**• Cost and benefit**

Cost is the measure of the alternative opportunities foregone in the choice of one good or activity over others. An economic benefit is any benefit that we can quantify in terms of the money that it generates.

**(b) What does the budget line show? In what cases it shift forward or backward?**

A budget line represents various combinations of two goods, which can be purchased with a given amount of money at the given price of each unit. An increase in consumer’s income will lead to a shift of the budget line to the right. A decrease in consumer’s income will shift the budget line to the left.

And a change in the price of the good can also shift the budget line forwards or backwards.