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* **Mid Term-summer semester 2020**
* **SUBJECT: Microeconomics**
* **SUBMITTED TO: Wajiha Amin**

Q.1 (a) Discuss briefly the concept of opportunity cost in economics .For each of the following what can be the potential opportunity cost.

## Opportunity Cost: Opportunity costs represent the benefits an individual, investor or business misses out on when choosing one alternative over another. While [financial reports](https://www.investopedia.com/terms/f/financial-statements.asp) do not show opportunity cost, business owners can use it to make educated decisions when they have multiple options before them. [Bottlenecks](https://www.investopedia.com/terms/b/bottleneck.asp) are often a cause of opportunity costs.

* Studying for your exam instead (playing football> opportunity cost)
* Spending 2 hrs playing computer games instead of (doing exercise> opportunity cost)
* Going to university instead (of staying at home. Opportunity cost)
* (You decide to spend $80 on some great shoes and (do not pay your electric bill> opportunity cost)

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

* 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 result in shrinkage of the total global gross domestic product.

**Positive Economics**

* An increase in tax rate ultimately decreased 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 us educated and emancipated.

**Normative Economics**

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

ANS:

 ***Total Utility (TU) First Graph***

The total satisfaction that a person gets from the consumption goods and service. Satisfaction peaked at unit number 6.

 ***Marginal utility (MU) Second Graph***

The additional to total utility as a result of consuming one more units of the same goods or services.

Marginal utility (MU) $=\frac{change in total utility }{change in total quantity}$

 MU=$∆TU$/$∆$ Q

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

ANS: We use this measure referred to as the Marginal rate of substitution (MRS) to quantify the amount of one good that a consumer is willing to give up to obtain more of another. It measures the value that an individual places on 1 extra unit of a good in terms of another. This concept is mostly talked about in context of slope of indifference curves (locus of points where utility remains constant) in consumer theory. Let us take the case of two goods X and Y to understand this.MRS of good X for good Y is the maximum amount of Y that a person is willing to give up to obtain an additional unit of X.

(c) Give any 2 characteristics of IC.

### ANS: 1. Indifference Curves Slop Downward To The Right:

This is an important and obvious feature of indifference curves. The sloping down indifference curve indicates that when the amount of one commodity in the combination is increased, the amount of the other commodity is reduced. This must be so if the level of satisfaction is to remain constant on the same indifference curve.

## 2. Higher Indifference Curves Are Preferred to Lower Ones:

## Consumers will always prefer a higher indifference curve to a lower one. This is due to the basic economic assumption that “[more is always better](https://quickonomics.com/2014/10/a-brief-introduction-to-economics/)“. Think about it if someone were to ask you if you wanted a free slice of pizza or an entire pizza for free, what would you say? Who says no to free pizza, right? Now, of course, it’s not always that simple, but in basic economic theory, we can assume that consumers have a preference for larger quantities. This is reflected graphically in the indifference map. The higher the indifference curves are, the larger the quantities of both goods. And thus, the more preferable the curve becomes.

Q3: (a) Differentiate between

ANS: **1 Cardinal And Ordinal Approach:**

Cardinal Utility is the idea that economic welfare can be directly observable and be given a value. For example, if a Nissan car gives 5,000 units of utility, a BMW car would give 8,000 units. On the other hand in ordinal utility, the consumer only ranks choices in terms of preference but we do not give exact numerical figures for utility. For example, we prefer a BMW car to a Nissan car, but we don’t say by how much.

**2. Marginal Utility And Total Utility:**

Total utility is the overall satisfaction a consumer derives from the consumption of particular goods and services. Each individual unit of goods or services has a marginal utility of their own. Total utility is the sum of marginal utilities of all such individual items.

Marginal utility is the concept used by economists to quantify the amount of satisfaction that is gained by consumption of additional units of a good or service. It is an important concept that is used by economists to determine how much quantity of an item a customer is willing to purchase. Marginal utility helps identify how the satisfaction levels influence the customer purchase decision.

**3. Cost:**

**Cost,** in common usage, the [monetary](https://www.merriam-webster.com/dictionary/monetary) value of goods and services that producers and consumers purchase. In a basic economic sense, cost is the measure of the [alternative](https://www.merriam-webster.com/dictionary/alternative) opportunities foregone in the choice of one good or activity over others. This fundamental cost is usually referred to as [opportunity cost](https://www.britannica.com/topic/opportunity-cost). For a consumer with a fixed income, the opportunity cost of purchasing a new domestic appliance may be, for example, the value of a vacation trip not taken.

* **Benefit:**

Economic benefits are benefits that can be quantified in terms of money generated, such as net income, revenues, etc. It can also be money saved when discussing a policy to reduce costs. How one measures economic benefits really depends on what he is analyzing. Economic benefits can be measured and used in business decisions, policy decisions, and market analyses. Businesses will probably use measures such as net income, net cash flow, or return on investment. Policy makers will likely use consumer and producer surplus measures.

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

ANS: A budget line shows the combinations of two products that a consumer can afford to buy with a given income – using all of their available budget. The gradient of the budget line reflects the relative prices of the two products i.e. the gradient of a budget line reveals the opportunity cost

The budget line will shift when there is:

* A change in the prices of one or both products with nominal income (budget) remaining the same.
* A change in the level of nominal income with the relative prices of the two products remaining the same.

### Shift in Budget Line:

Budget line is drawn with the assumptions of constant income of consumer and constant prices of the commodities. A new budget line would have to be drawn if either (a) Income of the consumer changes, or (b) Price of the commodity changes. Let us understand this with the example of apples and bananas.