CBSE Class–12 economics

Important Questions - Micro Economics 05

Market Equilibrium

VERY SHORT ANSWER QUESTIONS (1 Mark)

Q1. What is price taker firm?

Ans. Price taker firm is one who has no option but to accept the price determined by the industry.

Q2. What is price maker firm?

Ans. A price maker firm is one which can influence price on its own.

Q3. An individual firm under perfect competition cannot influence the market price, then who can and how?

Ans. Under perfect competition, the industry can influence market price by raising or lowering output.

Q4. What is cooperative oligopoly?

Ans. When in an oligopoly market, the firms cooperate with each other in determining price and output, that situation is called cooperative oligopoly.

Q5. What are advertisement costs?

Ans. Advertisement cost are the expenditure incurred by a firm for the promotion of its sales such as publicity through TV, Radio, Newspaper, Magazine etc.

Q6. What is meant by normal profit?

Ans. Normal profit is the minimum amount of profit which is required to keep an entrepreneur in production in the long run.

Q7. What do you mean by abnormal profits?

Ans. It is a situation for the firm when TR > TC.

Q8. Why AR is equal to MR under perfect competition?

Ans. AR is equal to MR under perfect competition because price is constant.

Q9. What are selling cost?

Ans. Cost incurred by a firm for the promotion of sale is known as selling cost.

Q10. In which market form is there product differentiation?

Ans. Monopolistic competition market

Q11. What do you mean by patent rights?

Ans. Patent rights is an exclusive right or license granted to a company to produce a particular output under a specific technology.

Q12. When a firm's TR>>TC, it cannot cover its normal profit

a) False

b) Can't say

c) TRUE

d) None of these

Ans. (a)

Q13. The quantity to be sold by a firm under perfect competition is also fixed by the market.

a) True

b) Can't say

c) None of these

d) False

Ans. (d)

Q14. A firm maximizes its profits only when MR=MC

1. False
2. None of these
3. True

4. Cannot say

Ans. (3)

Q15. Under perfect competition, market price can be influenced by both buyers and sellers.

1. True
2. False
3. None of the these
4. Cannot say

Ans. (2)

SHORT ANSWER QUESTIONS (3 / 4 Marks)

Q16. Explain two features of monopoly market.

Ans. The important two features of monopoly market is as follows:

1. There is only one single seller in the market so that the seller can influence the market price on its own.
2. There are entry barriers of new firms, this enables seller to get abnormal profits which is much more above normal profits.

Q17. Why is the number of firms small in oligopoly? Explain.

Ans. The main reasons why the number of firms are small in oligopoly is that there are barriers which prevent enty of firms into industry. Patents, large captial requiremnts control over the critical raw meterials,e tc all prevents new firm from entering the industry. Only those who are able to cross these barriers able to enter and stay in market.

Q18. Explain the implicaions of large buyer in a perfectly competitive market?

Ans. Large numbe r of buyers are assumed to be so large that an individual buyer's share in total purchases is so negligible that he cannot influence the market price on its own by purchasing more or less. The outcome is that price remains unchanged.

Q19. Explain the implications of the following:

a) **Interdependence between firms in oligopoly**

b) **Large number of sellers in perfect competition**

Ans.

A) Oligopolies are typically composed of a few large firms. Each firm is so large that its actions affect market conditions. Therefore, the competing firms will be aware of a firm's market actions and will respond appropriately. Mutual interdependence exists when the actions of one firm has a major impact on the other firms in the industry.

B) A perfectly competitive market is dominated by the presence of large number of buyers and sellers of a commodity, which means that there is no such buyer or seller in the market whose purchase or sale is so large as to impact the total sale or purchase in the market. Each buyer/seller has only a fractional share in the market demand/market supply.

Q20. Explain briefly why a firm under perfect competition is a price taker not a price maker?

Ans. A firm under perfect competition is a price taker not a price maker because the price is determined by the market forces of demand of supply. This price is known as equilibrium price. All the firms in the industry have to sell their outputs at this equilibrium price. The reason is that, number of firms under perfect competition is so large. So no firm can influence the price by its supply. All firms produce homogeneous product.

<u>LONG ANSWER QUESTIONS (6 Marks)</u>

Q21. Market for a good is in equilibrium. There is simultaneous increase both in demand and supply of the goods. Explain its effects on market price.

Ans. Equilibrium exits when there is no reason for a situation to change. When equilibrium exits, the quantity people plan to buy is equal to the quantity that producers plan to sell. The laws of demand and supply cause the market to move to equilibrium. The effect of increase in both demand and supply on equilibrium price and equilibrium quantity is discussed under three different cases:-

1. When increase in demand is equal to increase in supply: When increase in demand is proportionately equal to increase in supply, then rightward shift in demand curve from DD to D1D1 is proportionately equal to rightward shift in supply curve from SS to S1S1. The new equilibrium is determined at E1. As both demand and supply increase in the same proportion, equilibrium price remains the same at OP, but equilibrium quantity rises from OQ to OQ1.

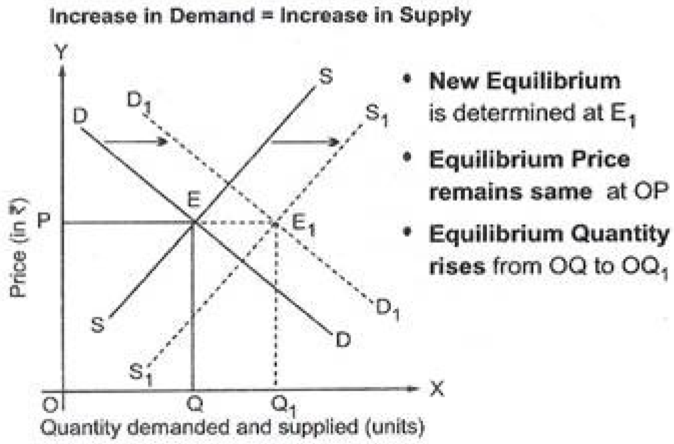


Fig. 11.13

2. When increase in demand is more than increase in supply: When increase in demand is proportionately more than increase in supply then rightward shift in demand curve from DD to D1D1 is proportionately more than rightward shift in supply curve from SS to S1S1. The new equilibrium is determined at E1 equilibrium price rises from OP to OP1 and equilibrium quantity rises from OQ to OQ1.

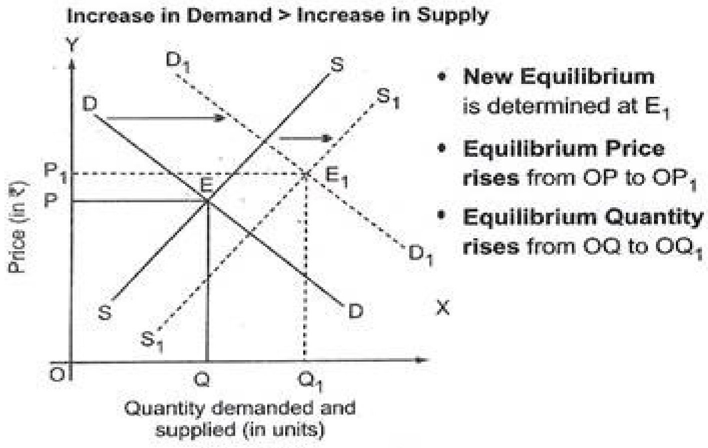


Fig. 11.14

3. **When increase in demand is less than increase in supply: When increase in demand is proportionately less than increase in supply, then rightward shift in demand curve from DD to D1D1 is proportionately less than rightward shift in supply curve from SS to S1S1. The new equilibrium is determined at E1 equilibrium price falls from OP to OP1 whereas, equilibrium quantity rises from OQ to OQ1.**

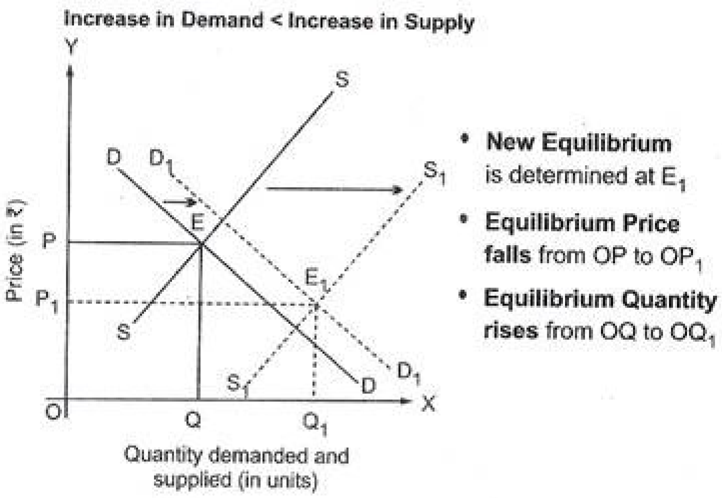


Fig. 11.15

Q22. Market for a good is in an equilibrium. There is simultaneous decrease both in demand and supply, but there is no change in the market price. Explain with the help of diagram, how it is possible.

Ans. When there is decrease in demand is more than decrease in supply, then there is no change in the market price. When decrease in demand is proportionately more than decrease in supply, then leftward shift in demand curve from DD to D1D1 is proportionately more than leftward shift in supply curve from SS to S1S1. The new equilibrium is determined at E1, equilibrium price falls from OP to OP1 and equilibrium quantity falls from OQ to OQ1.

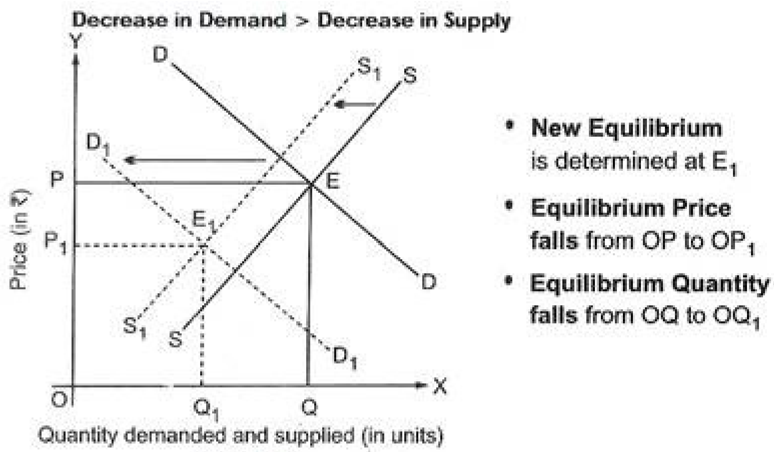
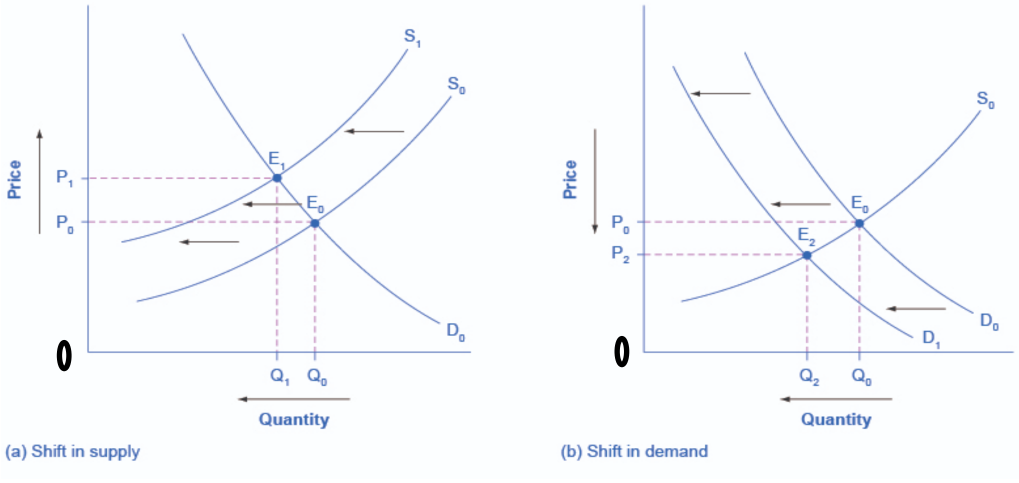


Fig. 11.11

Q23. How an equilibrium price and an equilibrium quantity of a normal commodity is affected by an increase in an income of the buyers? Explain with the help of diagram.

Ans. When an income of the consumers rises, demand curve for normal goods would shift to the right. Supply curve remains unaffected. However, when consumers are willing to pay higher price for the same quantity or because of increase in their income. This will tend price would tend to rise. Consequently, quantity supplied by the producers would tend to rise.

Thus, increase in demand and the consequent shift in demand curve to the right impacts producer's decisions by way of extension of supply in response to increase in price. Finally, you would end up in a situation, when an equilibrium price as well as an equilibrium quantity tend to rise, in response to an increase in demand.



OP = Initial equilibrium price

OQ = Initial equilibrium quantity

OP1 = New equilibrium price

OQ1 = New equilibrium quantity

Q24. How a fall in the price of tea will affects an equilibrium price of coffee? Explain the chain effects.

Ans. With a fall in price of tea, the demand of coffee that is substitute of tea decreases. As a result, demand curve of coffee shifts to the left. Accordingly, an equilibrium price would tend to decrease and also an equilibrium quantity tends to decrease.

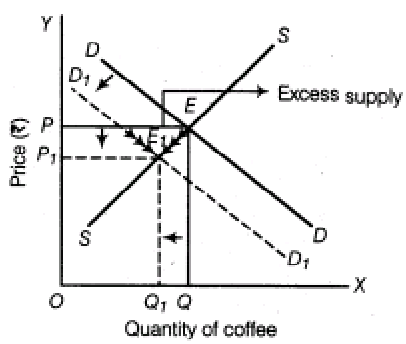


Diagram showing the decrement in equilibrium price and quantity

The figure shows a situation of decrease in demand. The demand curve shifts to left side. Consequently, equilibrium price and quantity, both are decreasing from OP to OP1 and OQ to OQ1.