

EXAMINATION QUESTION PAPER: Reassessment, 2014

Module code:	EC5006
Module title:	Microeconomics
Module leaders:	Dr. Eugenia Markova Dr. Verushka Oppedisiano

Date:	July/August 2014
Duration:	3 hours

Exam type:	Part Seen/ Part Unseen, Closed
Materials supplied:	None
Materials permitted:	Calculator
Warning:	Candidates are warned that possession of unauthorised materials in an examination is a serious assessment offence.

Instructions to candidates:	Candidates should answer ALL the questions in Section A and TWO questions from Section B.
	For each question 100 marks are available.
	DO NOT TURN PAGE OVER UNTIL INSTRUCTED

Section A: Seen Questions (20% of final mark)

(1)

Two firms are in the DVD market. Each can choose to go for the high end of the market (high quality) or the low end (low quality). Resulting profits are given by the following payoff matrix:

		<i>Firm 2</i>	
		<i>Low</i>	<i>High</i>
<i>Firm 1</i>	<i>Low</i>	30, 40	900, 700
	<i>High</i>	200, 800	60, 60

- What outcomes, if any, are Nash equilibria? **(40 marks)**
- If the managers of both firms are conservative and each follows a maximum strategy, what will be the outcome? **(40 marks)**
- What will be the (*subgame perfect*) equilibrium if Network 1 makes its selection first? And what if Network 2 goes first? *Note*: you have to derive the extensive form (i.e., game tree) representation of the above simultaneous-move game. **(20 marks)**

(2)

- Using a diagram to illustrate your answer, explain how a consumer solves the primal problem of consumer choice. That is, how does the consumer select the quantities of goods X and Y to consume to maximise utility, $U=u(X, Y)$, subject to spending the particular level of income M^* ? *Note* that the budget constraint is given by $M=P_xX + P_yY$, where P_x is the price of good X, P_y is the price of good Y and M is the level of income. **(40 marks)**
- Using a diagram to illustrate your answer explain what a corner solution is within the context of the problem of consumer choice referred to in (1) a. **(40 marks)**
- Find the own price elasticity and income elasticity of the following demand for good X: $X=1/2 (M/P_x)$. Briefly interpret the calculated elasticities. **(20 marks)**