KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2009/2010

INSTITUTIONAL BASED PROGRAMME (APRIL SESSION)

SECOND SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF SCIENCE IN AGRIBUSINESS MANAGEMENT

KBT 522: CONSUMER AND PRODUCER THEORY

DATE: THURSDAY, 2ND SEPTEMBER 2010 **TIME: 9.00 A.M. - 12.00 P.M.**

INSTRUCTIONS:

1. Be sure your **student number and other details specified** are printed clearly on the front of all exam booklets used.
2. **Please label clearly** each of your answers in the exam booklets with the appropriate number and letter.
3. **Please write legibly**.

Answer question One (1) and any other Three.

1. A variety of policies have been used in agricultural markets. One such policy is price supports and Government purchases. The central objective of almost all agricultural policies is to increase the prices producers receive for their products. One common approach is for the Government to set a support price above the competitive equilibrium price. However, this produces a surplus and Government must take action to "support" the higher price through direct Government purchase.

   a) Use graphical demand and supply schedules of the market for maize to analyzes the effects of the above Government support price. (10 marks)

   b) What quantity of maize are consumers willing to purchase? (5 marks)

   c) What quantity of maize are farmers willing to sell? (5 marks)

   d) What quantity of maize must the Government purchase and at what cost? (5 marks)

2. The competitive model is the most important part of microeconomic theory.

a) What are the four assumptions of the perfectly competitive model?

(16 marks)

b) Critics are fond of pointing out that few if any, real-world markets satisfy all four conditions, implying that the competitive model has little relevance for real-world markets. How would your respond to these critics?

(9 marks)

3. This question has four parts. Answer ALL the parts.

a) A firm has an attractive investment project. It can finance the project by borrowing funds at an interest rate of 10 percent. Alternatively, it can finance the project out of its current profits without borrowing. The firm's manager says it should choose the second method of finance because it is cheaper; no interest has to be paid. What do you say?

(6 marks)

b) If an employer is thinking of hiring one additional worker, will he or she be more concerned with the average product of labor or with the marginal product of labor? Why? (6 marks)

c) Distinguish between a normal good and an inferior good. (6 marks)

d) Separate the effect of an increase in price for an inferior good into its component income and substitution effects. (7 marks)

4. Explain and show graphically how the indifference curve and budget line apparatus is used to derive a consumer's demand curve. (15 marks)

a) For a demand curve certain things are held constant. What are they?

(5 marks)

b) How does the indifference curve and budget line derivation approach hold these things constant? (5 marks)

5. A tax of 10 shillings per kilogram is placed on organic whole meal maize flour. Use the supply-demand model to examine: (10 marks)

a) how this tax will affect the net-of-tax price received by sellers. (5 marks)

b) how this tax will affect the gross-of-tax price paid by buyers. (5 marks)

c) the amount of organic whole meal maize flour sold. (5 marks)

6. Consider a competitive market for which the quantities demanded and supplied (per year) at various prices are given as follows:

Price (Shs)	Demand (millions)	Supply (millions)
60	22	14
80	20	16
100	18	18
120	16	20

a) Calculate the price elasticity of demand when the price is 80. When the price is 100. (6 marks)

b) Calculate the price elasticity of supply when the price is 80. When the price is 100. (6 marks)

c) What are the equilibrium price and quantity? (6 marks)

d) Suppose the government sets a price ceiling of 90. Will there be a shortage, and if so, how large will it be? (7 marks)

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