CBSE Test Paper-05

Class – 11 Economics (Forms of Market and Price Determination)

General Instruction:

- All questions are compulsory.
- Marks are given alongwith their questions.

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1. Suppose that the demand curve for the XYZ Co. slopes downward and to the right. We can conclude that
   a. The firm operates in a perfectly competitive market.
   b. The firm can sell all that it wants to at the established market price.
   c. The XYZ Co. is not a price taker in the market because it must lower the price to sell additional units of output.
   d. The XYZ Co. will not be able to maximize profits because price and revenue are subject to change. (1)
2. Suppose the technology for producing personal computers improves and, at the same time, individuals discover new uses for personal computers so that there is greater utilization of personal computers. Which of the following statements/factors will happen to equilibrium price and equilibrium quantity?
   a. Price will increase; quantity cannot be determined.
   b. Price will decrease; quantity cannot be determined.
   c. Quantity will increase; price cannot be determined.
   d. Quantity will decrease; price cannot be determined. (1)
3. When do we say there is excess demand for a commodity in the market? (2)
4. Giving reasons, state whether the following statements are true or false: a. Equilibrium between demand and supply helps in determining prevailing price of the product. b. In case of excess demand, equilibrium price is less than prevailing price. (2)
5. What is cartel? (3)
6. What is meant by price rigidity, under oligopoly? (3)
7. Explain the changes that will take place when in a market the demand for a good is greater than supply at the prevailing price. (4)
8. Mrs Ramgopal says that economists say inconsistent things: as price falls, demand rises

but as demand rises, prices rises. Defend or refute. (4)

9. At a given price of a commodity, there is an excess supply. Is it an equilibrium price? If not, how will an equilibrium price be reached? Use diagram. (6)
10. Giving reasons, distinguish between the behaviour of demand curves of firms under perfect competition and monopolistic competition. (6)

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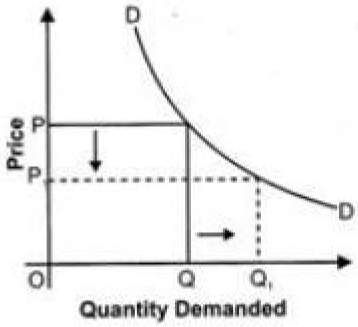
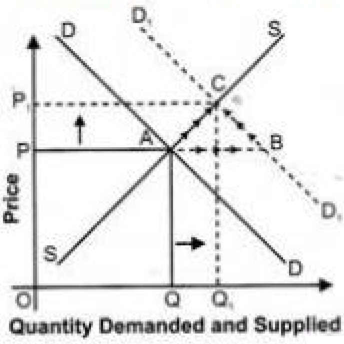
Answers

1. C. The XYZ Co. is not a price taker in the market because it must lower the price to sell additional units of output.
2. C. Quantity will increase; price cannot be determined.
3. When Market price is below the equilibrium price, then at that given price, demand is greater than supply, which leads to excess demand.
4. a. False: An equilibrium between demand and supply determines only equilibrium price.
   b. False: When there is excess demand, equilibrium price is greater than prevailing price.
5. A Cartel is a group of firms which jointly set 'output and price' policy of its product in such a way so as to reap benefits of monopoly.
6. Price rigidity refers to a situation in which whether there is change in demand and supply the price tends to stay fixed.
   If a firm tries to reduce the price the rivals will also react by reducing their prices. Likewise, if it tries to raise the price, other firms will not do so. It will lead to loss of customers for the firm which intended to raise the price.
7. If at a prevailing price, quantity demanded is more than quantity supplied then supplier will motivate to increase the price of the commodity due to which demand decreases, till it reaches at the equilibrium price where quantity demanded is equal to quantity supplied.
8. We defend the statement of Mrs Ramgopal. As price falls, demand rises. According to Law of Demand, there is inverse relationship between demand and price. Leaser price leads to higher demand.
   Demand = f (price)
   When demand rises, prices also rises. Price is function of twin forces of demand and supply.
   Price = f (demand, supply)
   In the given figure, price is measured on vertical axis and quantity demanded and supplied is measured on horizontal axis. Initially, the equilibrium price is OP and

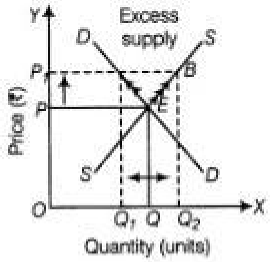
equilibrium quantity is OQ. But due increase in demand, the demand curve shifts rightward from DD to D1D1.



With new demand curve D1D1, there is excess demand at initial price OP because at price OP, demand is PB and supply is PA, so there is excess demand of AB at price OP.
Due to this excess demand, competition among the consumer will raise the price. With the rise in price, there is upward movement along the demand curve (contraction in demand) from B to C and similarly, there is upward movement along the supply curve (expansion in supply) from A to C . So, finally equilibrium price rises from OP to OP1 So, demand rises, price rises.

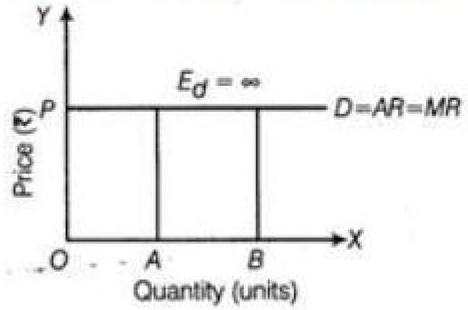


9. By the definition, an equilibrium price refers to the price at which market demand is equal to market supply (i.e. there is no excess demand or excess supply).
When price prevailing in the market is higher than an equilibrium price, demand will be less than supply i.e. there is excess an supply in the market. Excess supply will force the market price to slide down causing an extension of demand and contraction of supply. The process of an extension and contraction would continue till the equilibrium between supply and demand is struck. Thus, an equilibrium price will be restored through the free play of market forces.
No, the price with excess supply is not an equilibrium price. This can be illustrated with the help of the given diagram.



Determination of equilibrium price

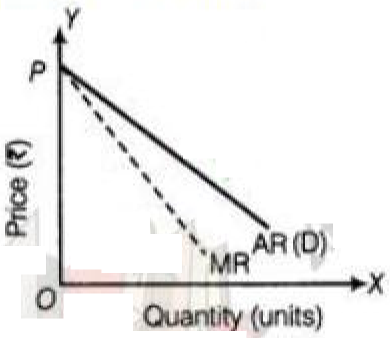
10. i. Demand curve of the firm under perfect competition:



Demand curve is perfectly elastic. It means that a firm can sell any amount Of the commodity at the prevailing price. Even a fractional rise in price would wipe out entire demand for the firm's product. Firm's demand curve is indicated by a horizontal straight-line parallel to X-axis.

This shows that the firm has to accept the price as determined by the market forces of supply and demand; it can sell whatever amount it wishes to sell at this price.

ii. Demand curve of the firm under monopolistic competition:



Demand curve is more elastic. Under monopolistic competition, the firm faces a negatively slope demand curve. It means that a large quantity of the commodity can be sold by decreasing its price. But demand curve here is more elastic than the demand curve faced by monopoly firm. It is because of availability of close substitutes in the market.