CBSE Test Paper-07

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. Monopolistic competition differs from perfect competition primarily because-
   a. in monopolistic competition firms can differentiate their products.
   b. in perfect competition firms can differentiate their products.
   c. in monopolistic competition entry into the industry is blocked.
   d. in monopolistic competition, there are relatively few barriers to entry. (1)
3. A severe drought results in a drastic fall in the output of wheat. Analyze how will it affect the market price of wheat? (2)
4. Giving reasons, state whether the following statements are true or false:
   a. Equilibrium price will not change if the decrease in demand meets with a proportionate decrease in supply.
   b. If the supply curve is a horizontal straight line, change in demand will affect equilibrium quantity. (2)
5. Giving reasons, state whether the following statements are true or false:
   a. Product differentiation is a characteristic feature of a monopolistic competitive market,
   b. A monopolist cannot fix both the quantity that he likes to produce and the price at which he would like to sell. (3)

6. Market for a good is in an equilibrium. There is an increase in demand for this good. Explain the chain of effects. (3)
7. Suppose the price of a good is higher than equilibrium price. Explain the changes that will establish equilibrium price. (4)
8. "Demand and supply are like two blades of a pair of scissors". Comment. (4)
9. Market for a good is in an equilibrium. There is simultaneous decrease both in demand and supply, but there is no change in market price. Explain with the help of a schedule, how is it possible. (6)
10. Explain the implications of the following
    i. Differentiated products under monopolistic competition.
    ii. Large number of sellers under perfect competition.
    iii. Barriers to the entry of firms under oligopoly (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. A. in monopolistic competition firms can differentiate their products
3. Market price of wheat will increase (due to decrease in supply).
4. a. True: Decrease in demand results in a fall in equilibrium price; decrease in supply, on the other hand, results in an increase in price. If both the changes are proportionately equal, equilibrium price will not change.
   b. True: A horizontal straight line supply curve implies that the quantity supplied can be adjusted to the change in demand. With the increase in demand, with no corresponding increase in price, equilibrium quantity will increase.
5. a. In a monopolistic competitive market there is a large number of producers. But each of these producers produces a product which is somewhat different from what others do. At least, the producers make all the attempts to influence the consumer with the idea that their product is better than the product of the rival producers.
   b. A monopolist is faced with a downward sloping curve. He can sell a larger quantity at a lower price; or alternatively, he may charge a higher price and be satisfied with lower quantity. He has to make a choice between the two alternatives.
6. The given diagram shows a situation of increase in demand. The demand curve shifts to the right from DD to D1D1 an equilibrium point shifts from E to E_1 Consequently, an equilibrium price and an equilibrium quantity rises from OP to OP, and OQ to OQ1 respectively.
   The chain effects of increase in demand - When there is a increase in demand it creates excess demand (equal to O Q_2) at initial price OP and as a result of which price will rise. With rise in price, demand will start falling (according to Law of Demand) and supply will start rising (according to Law of Supply), this process will continue till the time we reach new equilibrium level at E1 where there is no excess demand.

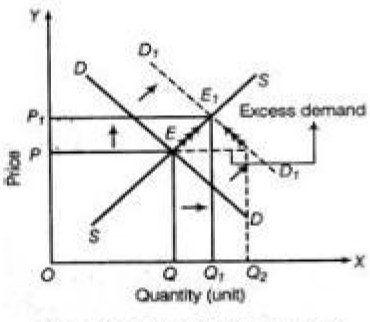

Diagram showing situation of excess demand

7. When price prevailing in the market is higher than that of equilibrium price, demand will be less than supply i.e. there is excess supply in the market. Excess supply will force the market price to slide down causing 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 of demand and supply.

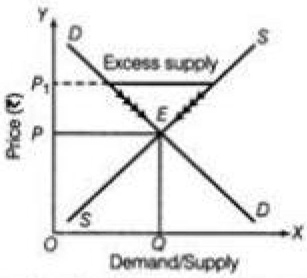

Diagram showing the situation of excess supply

8. The given statement is correct. Both the blades of a pair of scissors are equally important to cut a piece of cloth. Similarly, both demand and supply are needed for determining price in the market. There is no use for demand for a product if there is no supply for the product and supply is not needed if there is no demand for the product. One of the two may play more active role in price determination in the short run. But, both are needed to determine the price in the long run.
9. Decrease in demand is greater than decrease in supply - If decrease in demand is greater than the decrease in supply, an equilibrium price and quantity will fall.

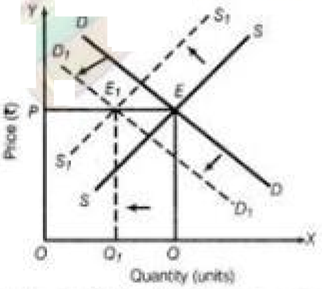

Diagram showing fall in equilibrium price and quantity

From the figure, it is clear that the (leftward) shift in demand curve from DD to D1D1 is proportionately more than the (leftward) shift in supply curve from SS to S1S1 The new equilibrium point is £,. Equilibrium price falls from OP to OP1 and an equilibrium quantity falls from OQ to OQ1 Decrease in quantity is greater than decrease in price.

Price of commodity X $(Rs.)$	**Quantity of commodity X (Demand) (Dozen)**	**Quantity of commodity X (Supply) (Dozen)**
5	50	50
5	40	40
5	30	30
5	20	20
5	10	10

10.
   i. Product differentiation It is a distinct feature of monopolistic competition. A product is often differentiated by way of trademarks and brand names size, quality, quantity etc. The differentiated products are close substitutes of each other, like Colgate and Close up toothpaste. Because of product differentiation, each firm can decide its price policy independently. So, that each firm has a partial control over price of its product. This is done to attract buyers from the rival firms in the market. Also because of this firms produce an excess capacity (quantity), as their product is different and hence they have some consumers who always consumes their products only.
   ii. Large number of sellers There are very large number of buyers and seller are present in the market as a result of which size of each economic agent is so small as compared to the market that they cannot influence the price through their individual actions.
   iii. Barriers to the entry of firms There are various barriers or restrictions to the entry of new firms. These barriers are almost similar to those under monopoly. Entry of the new firms is extremely difficult, if, not impossible. These barriers can be natural like requirements of huge capital or operating at minimum average cost of artificial barriers like patent rights which prevents entry of new firms in the industry.