

7 Supply

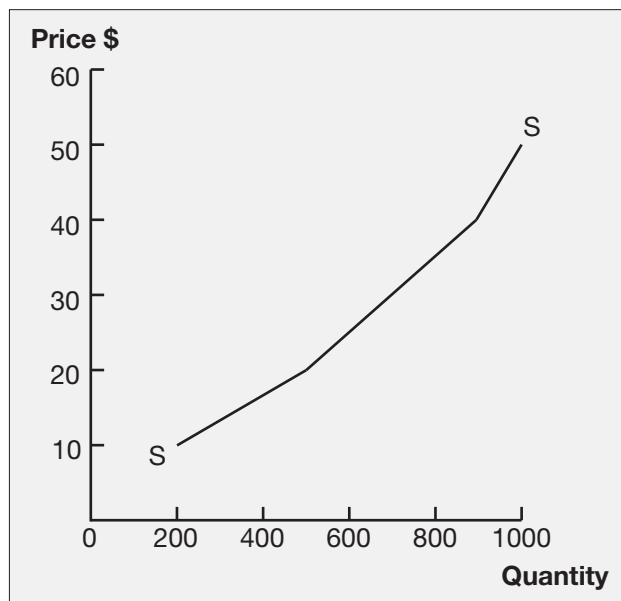
Multiple Choice Answers

1	C	6	C	11	C
2	B	7	A	12	B
3	B	8	B	13	A
4	D	9	C	14	B
5	D	10	B	15	B

Short Answer Questions

Question 1

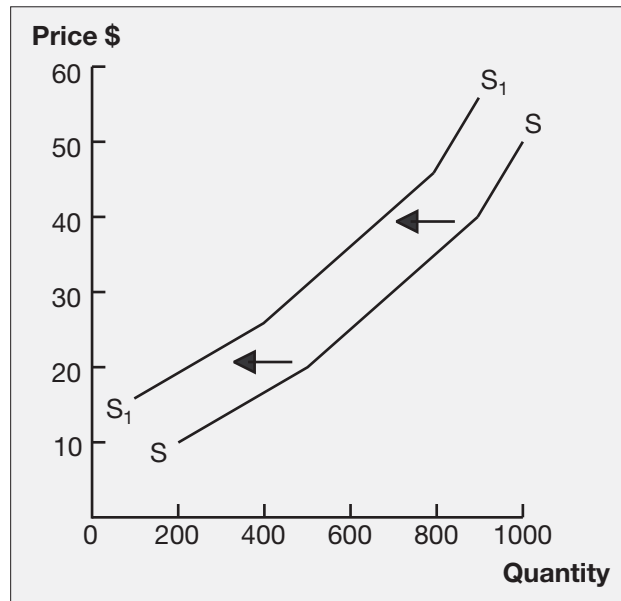
(a)



(b) 70 units

(c) $900 - 500 = 400$ units

(d)



- (e) The law of supply states that as prices rise, the quantity supplied within the industry will also rise. This will occur for two reasons. Firstly, firms will generally be willing to produce a higher quantity at a higher price since there will be higher revenues received. Also, as a firm increases its quantity of output, it may start to experience internal diseconomies of scale, which raise the cost of production, causing prices to rise.

Question 2

- (a) A decrease in supply
- (b) \$12
- (c) A decrease of 100 units
- (d) A correct answer may include any two of the following:
- A rise in the price of other goods would see firms leave the original industry seeking higher prices. This would reduce overall firms in the industry, decreasing supply.
 - A rise in the cost of the factors of production (such as higher wages) will mean that at a particular price, a firm will be forced to supply fewer products, decreasing supply.
 - A decrease in the quantity of resources available will restrict the quantity of possible production and raise input costs, lowering supply.
 - Unfavourable climatic conditions, or other external diseconomies of scale may destroy or reduce the quantity a firm can produce, decreasing supply.

Question 3

- (a)** Price elasticity of supply is the responsiveness of quantity supplied to changes in the price received for the product.
- (b)** The diagram illustrates perfectly inelastic supply. Suppliers are willing to supply only a fixed quantity of the good, and for any change in price will not alter the quantity supplied.
- (c)** A firm with excess capacity will be able to respond quickly to any change in price by increasing its production, allowing the firm to respond with a larger than proportional increase in quantity to take advantage of an increase in prices.
- (d)** The length of time after a change in supply will change the elasticity of supply. In the short run, firms may find it difficult to increase production. As time passes, firms can increase their factors of production (e.g. by hiring new workers) to increase quantity, allowing quantity to respond. The ability to hold inventory (or stock) affects elasticity, since the more inventory a firm has, the faster it can respond to a change in price.