UNIVERSITY OF COLOMBO

FACULTY OF ARTS - DEPARTMENT OF ECONOMICS

Postgraduate Diploma in Economic Development (DED) – 2016

DED 501: Economic Theory and Developing Countries

Answer Four (04) Questions selecting at least one (01) question from each part

Time Allowed: 03 Hours Only

Part A

01. (a). Free market is said to be the best possible way to deliver economic efficiency in an economy.When free markets do not deliver optimum resource allocation, it is described as a market failure. Explain reasons for market failures.

    (15 marks)

    (b) Government responds to externalities through two policy approaches. Explain these approaches. (10 marks)

02. (a) distinguish between profits maximization behaviour of a firm under monopoly and perfect competition using suitable diagrams.

    (10 marks)

    (b) Interdependency is one of the major characteristics of oligopoly however, its behaviour is complicated. Justify this statement using appropriate examples.

    (10 marks)

    (c) What is the price discrimination in monopoly? What conditions would have to be fulfilled in the market for a price discrimination? Use appropriate diagrams where necessary.

    (05 marks)

03. (a) What are the key points in a short-run production?Explain the relationship between the law of diminishing returns and the three stages of production? Where would a "rational" firm operate in the three stages and why? Use the relevant diagrams where necessary.

    (10 marks)

    (b) Are there any reasons for a firm to decide its production in Stage 1 or Stage 111 of the short-run production?

    (10 marks)

    (c)Using relevant theoretical underpinnings, differentiate between long run and short run production theory. Examine their applicability to the real world.

    (05 marks)

04. (a). Explain the concept, 'consumer equilibrium' using the theory of indifference curves and budget lines.

    (10 marks)

    (b). Indifference curves can be convex to the origin, linear or L shaped. What does each of these shapes tell you about the nature of consumer utility?

    (10 marks)

    (c). "Indifference curves cannot cross" explain the statement using a diagram

    (05 marks)

Part B

05. (a). Briefly explain the main macroeconomic objectives in an economy. State the policies that the government can use to achieve these objectives and examine the relative importance of these policies in relation to developing countries.

(10 marks)

(b). What are the factors that support and obstruct the economic growth of a country? Briefly explain.

(05 marks)

(c). what are the neo liberal policies? Critically examine the benefits and incompatibilities of these policies in relation to the developing countries.

(05 marks)

06. The following equations describe a hypothetical economy. (Consumption expenditure (C), investment expenditure(I), government expenditure(G), net export (NX) are measured in Rs. Millions and 't' is proportional tax ratio).

$$C = 100 + 0.75Y \qquad t = 0.2$$
$$G = 200 \qquad I = 150 \qquad NX = 10$$

(a). Derive the savings function of this economy.

(02 marks)

(b). What is the equilibrium level of income in this case?

(06 marks)

(c). Calculate the value of investment multiplier.

(03 marks)

(d). What are the level of savings at equilibrium national income? Does $S = I$ at equilibrium? Why or Why not? Explain.

(04 marks)

(e). Assume that the government has decided to spend Rs. 60 million on an irrigation project. Calculate the new equilibrium level of income.

(05 marks)

(f). Draw a simple graph to show all these results.

(05 marks)

07. (a). What is the structural unemployment? Illustrate your answer. Explain briefly the causes behind the structural unemployment.

(10 marks)

(b). Explain the states of natural rate of unemployment, demand deficient unemployment and unemployment in negative supply shocks using appropriate diagrams.

(08 marks)

(c). Explain briefly the negative consequences of unemployment.

(07 marks)

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