

UNIVERSITY OF COLOMBO
FACULTY OF ARTS

Postgraduate Diploma in Economic Development (PgDED) – 2018
(First Semester)

PgDED 5101: Economic Theory for Development

Answer Four (04) Questions choosing at least one question from each part.

Use Separate Books to Answer Questions from Part A and Part B

Time Allowed: 03 Hours Only

Part A

1.

a.) Use the theory of demand to describe following situations.

- Demand for Gems increases with gem price.
- Demand for travel by public transport decreases with increase of income.
- Demand for breads and price of breads has been increased in last 3 years' time.

(03 Marks each)

b.) Following table provides elasticity calculations for Beer and Illicit alcohol. Use this information to answer the question given below.

	Beer	Illicit Alcohol
Own Price Elasticity	-0.25	-0.75
Cross-price Elasticity	0.45 (against Illicit alcohol price)	0.25 (against beer price)
Income Elasticity	0.05	-0.55

- Interpret the elasticity coefficient given above highlighting the nature of each commodity, the relationship between the two commodities and theoretical explanations for the differences of each elasticity coefficient between the two commodities.

(12 Marks)

c.) Theoretically it is expected that the own-price elasticity is positively related with the own-price. Explain the reasons for this theoretical expectation.

(04 Marks)

2.

a.) Define and list the key properties of "production function".

(04 Marks)

b.) Explain the key differences between short-run and long-run production functions and also describe the relevant theorems to describe the short and long run input-output relations.

(08 Marks)

c.) What is the "elasticity of factor substitution"? How can it be measured?

(05 marks)

d.) How do economists define "economic efficiency"? Use appropriate graphical devices to describe your answer.

(08 Marks)

3.

a.) Why is that economists believe that the long-run equilibrium price of perfectly competitive markets is the "best price" from efficiency and social welfare point of views?

(04 Marks)

b.) What is the key similarity and key difference between the long-run equilibrium of perfect competition and monopolistic competition?

(05 Marks)

c.) What is price-leadership in Oligopoly market? Explain the three types of price-leadership with examples.

(06 Marks)

d.) What is "Rent Seeking" and use an appropriate diagram to show the maximum amount that a monopolist is willing to spend to avoid new comers to the market.

(10 Marks)

4.

a.) Ronald Coase has defined two conditions for efficient functioning of capitalist system. Explain them.

(08 Marks)

b.) Show that in the real world two conditions proposed by Ronald Coase for the efficient functioning of capitalist system are mutually contradictory.

(08 Marks)

c.) Describe the sources of "transaction cost" in real world economic systems.

(09 Marks)

Part B

5.

a.) State the main macro-economic objectives of an economy and examine in brief the trade-off in achieving these objectives.

(07 marks)

b.) "Fiscal policy is more effective than monetary policy in macroeconomic management in developing countries" Do you agree? Examine this statement taking into account the theoretical and practical limitations with regard to these policies.

(10 marks)

c.) Why developing countries cannot achieve a higher rate of economic growth? Briefly explain this taking into account the different constraints on economic growth.

(08 marks)

6.

The following equations describe a closed hypothetical economy. (C, I, G, TR are measured in Rs. billions)

$$\begin{array}{lll} C = 250 & MPC = 0.8 & t = 0.15 \\ G = 200 & I = 150 & T = 20 \end{array}$$

a.) Derive the consumption function of this economy.

(02 marks)

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

(06 marks)

c.) What are the levels of consumption and savings under equilibrium national income?

(03 marks)

d.) As a policy decision, the government decided to increase by a 10% income tax on high income earners. What would be the new level of national income?

(08 marks)

e.) Suppose that the government has decided to spend Rs. 50 billion on low income earners as a direct transfer payment (TR). Calculate the new equilibrium level of income.

(06 marks)

7.

(a.) Distinguish between unemployment and under-employment. Explain the causes for unemployment according to the Keynesian view.

(09 marks)

b.) What is the structural unemployment? Explain different conditions that structural unemployment would occur.

(08 marks)

c.) Explain the Natural Rate of Unemployment, Demand-deficient Unemployment, Unemployment in Negative Supply Shock using suitable diagrams.

(08 marks)