

UNIVERSITY OF COLOMBO

FACULTY OF ARTS

SECOND YEAR EXAMINATION IN ARTS (ECONOMICS) -2018

END OF THE SECOND SEMESTER

ECN 2224 – Economic Analysis

Time: 2 Hours

Answer 2 questions from Part A and 2 questions from Part B

Part A

1.

(a) How does rational expectations formulation differ from adaptive expectations formulation? Explain using the example of expectations formulation regarding inflation.

(5 Marks)

(b) Explain the Feige and Pearce model for determining the optimal quantity of information to be used under rational expectations.

(5 Marks)

(c) Using a diagram, explain why discretionary expansionary fiscal policy will only lead to a short term growth in output. What is the outcome in the long run?

(5 Marks)

(d) "Monetary policy if it is rule based will be ineffective in achieving an increase in output even in the short run". Explain.

(5 Marks)

(e) New Classical Economists reject government intervention labelling it as ineffective. However, there are three situations under which government intervention could be beneficial. What are these three exceptional situations?

(5 Marks)

2. (a) Discuss the following labour market situations

(i) Efficiency wages

(ii) Insider-outsider model

(5 Marks per section)

(b) Using diagrams, briefly explain why unemployment occurs in the labour market and the macro-economy.

(8 Marks)

(c) The demand for exports reduces in a country with wage contracts. Using a diagram show what could happen to output and prices, in the short run and the long run. Would using government intervention resolve the problem? If yes, what sort of government intervention should be adopted?

(7 Marks)

(3) Discuss briefly the empirical changes that occur in the following variables during the different stages of the business cycle.

- (i) Prices
- (ii) Profits

(3 Marks per section)

(b) Explain one (01) of the following business cycle models

- (i) Samuelson model
- (ii) Hicks model

(6 Marks)

(c) Explain the two types of business cycles put forward by New Classical Economists.

(6 Marks)

(d) New Classical and New Keynesian Economists consider the role of the state to be different in controlling business cycles. Explain.

(7 Marks)

Part B

4. (a) Explain the meanings of technical efficiency and allocative efficiency, and show how to measure them.

(12.5 Marks)

(b) How do you show that perfectly competitive markets are efficient in the long run?

(12.5 Marks)

5. (a) Distinguish between private goods and public goods. Why should the government provide public goods?

(12.5 Marks)

(b) Explain the difference between market failure and government failure using appropriate examples.

(12.5 Marks)

6. (a) Show how you can use Nash equilibrium to solve this problem:

		Player 2		
		L	C	R
Player 1	T	4 0	5 3	0 4
	M	0 4	5 3	4 0
	B	3 5	6 6	3 5

(4 Marks)

(b) Using the Iterated dominant strategy find the solution for the problem given below.

		Player 2		
		L	C	R
Player 1	T	1 2	1 0	0 0
	M	0 1	0 3	2 0
	B	0 1	1 0	1 0

(5 Marks)

(c) Explain the game 'Prisoner's dilemma', using a hypothetical numerical example.

(4 Marks)

(d) Calculate the following if $P(Q) = a - Q$ and $MC = c$ and a Cournot model of duopoly exists

- (1) Quantity produced by each firm
- (2) Market quantity
- (3) Why is sharing the monopoly market (collusion) better than competition in the duopoly case?
- (4) Will such a collusion be successful in the long run?

(3 Marks each)

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