

OLLSCOIL NA hEIREANN
THE NATIONAL UNIVERSITY OF IRELAND, GALWAY

SEMESTER I EXAMINATION 2001

ECONOMIC THEORY (EC349)
B.A. & B.Comm. Degree Examination

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Time allowed: 2 hours. (Non English Speakers $2\frac{1}{2}$ hours).

SECTIONS 1 AND 2 MUST BE ANSWERED
USE SEPARATE ANSWER BOOKS FOR SECTIONS 1 AND 2

SECTION 1: MICROECONOMICS

Answer TWO of the following questions. Each question is worth equal marks

1.
 - (i) Explain how the concept of diminishing returns give us negatively sloped demand curves and positively sloped supply curves.
 - (ii) Explain how multiple equilibria could arise in markets and its implications for the efficiency of the market mechanism as an allocator of resources.
 - (iii) A standard algebraic approach to finding the optimal allocation of scarce resources is the Lagrangian method (where the optimum always occurs where the marginal rate of substitution of two activities equals relative prices). Under what circumstances would such an approach be either not feasible or not correct?

2.
 - (i) How does expected inflation between time periods 1 and 2 change the inter-temporal budget constraint for an individual (assuming that this individual is a saver). What effect would you expect it to have on (a) consumption in the first period (b)) consumption in the second period and (c) savings
 - (ii) How does expected inflation between time periods 1 and 2 change the inter-temporal budget constraint for an individual (assuming that this individual is a borrower). What effect would you expect it to have on (a) consumption in the first period, (b) consumption in the second period and (c) borrowings

3. (i) Explain how economists could assert that goods in kind (such as compulsory education) are less desirable (from an efficiency perspective) than the policy of giving equivalent financial resources to families. Can you think of any reasons why such a conclusion may be flawed?
- (ii) Discuss the usefulness and limitations of prices indices as a measure of change in consumer welfare.
4. (i) Explain the logic that underpins the First Welfare Theorem.
- (ii) What are the implications of the Pareto efficiency concept for issues of equity in society?

SECTION 2: MACROECONOMICS

Answer two questions from this Section. Each question carries the same mark.

5. Distinguish between money financing and bond financing of government deficits.
6. In the context of the new classical macroeconomics, differentiate between an anticipated and an unanticipated change in monetary policy.
7. 'There is always a temporary trade-off between inflation and unemployment; there is no permanent trade-off. The temporary trade-off comes not from inflation per se, but from unanticipated inflation ...' Comment on these remarks.
8. Is a reduction in the real wage rate always sufficient to reduce unemployment?