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NATIONAL UNIVERSITY OF IRELAND, GALWAY
OLLSCOIL NA hEIREANN, GAILLIMH
Semester 2 Examination 2001/02

EC385 Advanced Economic Theory

B.A. Degree & B. Comm. Degree Examination

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Time allowed: 2 hours
(Two questions from both section A and section B must be answered. All questions carry equal marks.)

USE SEPARATE ANSWER BOOKS FOR SECTIONS A AND B

SECTION A

Instructions: Answer two out of the following four questions.

1. (i) Discuss the role of property rights in the Coasian response to the inefficiencies of externalities.

   (ii) How can a Pigovian tax induce a polluting agent to produce at the socially optimum output level?

2 (i) Explain the concepts of non-rivalry and non-excludability in the provision of public goods. Will the market provide a good that is rival but non-excludable? Why?

   (ii) The problem of Moral Hazard arises when the employer cannot perfectly observe the amount of effort expended by the employee. Discuss, using the shirking model developed in class, the different equilibrium outcomes when (assuming effort is unobservable) an employee is paid a flat salary as apposed to when she is paid as a residual claimant.

3 (i) Explain why under perfect competition marginal revenue (MR) equals price while under monopoly power MR is less than price. Prove that MR will fall twice as fast as AR (Price) when the demand curve facing the monopolist is linear.

   (ii) Discus the equilibrium position of a monopolist when it is able to identify separate groups of buyers and charge them different prices (assume marginal cost is constant). What are the welfare effects of third-degree price discrimination?

4 (i) Explain why it would make economic sense for a government to subsidise the output of a domestic firm that is competing in a duopolistic market with a foreign firm. Does such intervention result in enhanced global efficiency in that market?

Note: We define national economic welfare as the profits of the domestic firm minus the cost of the government subsidy.

(ii) The following are the payoffs to a multinational (MNE) and the host country if a MNE locates there.

	Country 1	Country 2
Profits to MNE	\$10m	\$8m
Economic rent to host country if MNE locates	\$4m	\$8m

In a bidding war between the two countries, who would win and what would the net pay off be to the host country? Is there any collusive outcome in this game that could make both countries better off?

SECTION B

Instructions: Answer two out of the following four questions.

1. Comment briefly on *any two* of the following

   (a) Menu costs

   (b) Convergence

   (c) Kaldor on the consistency between the warranted and natural rates of economic growth

   (d) Multiplier-accelerator theory of the business cycle

2. Outline the effects of fiscal policy in a small open economy with a flexible exchange rate.

3. Distinguish between rules and discretion in the conduct of monetary policy.

4. What is the AK model of economic growth? Why does the AK model produce continuing growth in the absence of technical progress, while the Solow model does not?