

**OLLSCOIL NA hEIREANN
THE NATIONAL UNIVERSITY OF IRELAND, GALWAY**

AUTUMN EXAMINATION 2002

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

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Ms. Eithne Murphy**

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) Using the Lagrangian method, the optimal allocation of scarce resources occurs where the marginal rate of substitution of the two activities equals their relative prices. Describe various types of preferences where the Lagrangian approach would (a) yield an incorrect answer or (b) be infeasible.
2.
 - (i) How does an increase in the rate of interest change the inter-temporal budget constraint for a saver. What effect would an increase in the rate of interest have on consumption in the first period, consumption in the second period and savings. (In your answer be sure to work through the income and substitution effects associated with the interest rate change)
 - (ii) Show the effect of an increase in the wage rate on labour supply. (Once again be sure to make reference to income and substitution effects).
3.
 - (i) Why do economists consider goods in kind to be less desirable from a policy perspective than giving citizens equivalent financial resources?

Can you think of any reasons why the logic of economists may be flawed in this regard

- (ii) Discuss the usefulness and limitations of price indices as a measure of changes in consumer welfare
- 4.
- (i) Explain the logic that underpins the first welfare theorem.
 - (ii) What are the strengths and weaknesses of Pareto efficiency as a guide to policy.

SECTION B

Answer any two of the following questions :

1. Outline equilibrium in a small open economy with a fixed exchange rate
2. What, according to the new classical macroeconomics are the results of an expansion in monetary policy?
3. Consider the effects of an increase in government purchases taking account of the government budget constraint.
4. Do changes in the money wage rate affect unemployment?