Faculty of Economics and Business Universitas Indonesia (FEBUI)
Undergraduate Regular (S1 Regular)

Final Exam

Odd Semester 2018/2019

ECEU607102 – Regional Economics (Prof. Iwan Jaya Azis)

Maximum Time Allowed: 3 hours

Please answer all questions below. It is not allowed to use programmable calculator!

I. Inequality Between Regions: Neo-Classical Vs Spatial Economics

In explaining unequal distribution of regional activities, history and comparative advantage matter. The comparative advantage is reflected in physical dimension (e.g., richness in natural resources, favorable geography) and locational advantage (e.g., greater market size, abundant primary factors). This explains why some regions had developed at the early stage than others. Given such an initial condition, mitigating policies are recommended among others through infrastructure development in the less-developed regions. Together with the potential negative externality of concentrated activities in the developed regions (e.g., congestion, etc), the policies are expected to counter the forces of concentration (centripetal) on the one hand, and strengthen the forces of dispersion (centrifugal) on the other. Yet, in most countries inequality between regions remain widespread.

a) Seen from the equilibrium paradigm a-la neoclassical economics, a spatial configuration showing unequal distribution of activities between regions can be explained by the interregional capital movement (ICM) model with certain conditions. Explain the assumptions and the standard mechanisms of the model, and show the conditions that must hold for the model to generate increased inequality between regions.

b) In spatial economics, the phenomenon of concentration is explained by agglomeration forces (Thünen, Christaller, Lösch, Weber, Isard, Fujita), economies of scale (Marshall), and benefits of urban interaction (Jane Jacob). After identifying the different assumptions of neo-classical ICM and spatial economics, explain how agglomeration emerges, and together with technological progress how it could generate different conclusion from that postulated by the neo-classical model as to the outcome of the interplay between concentration and dispersion forces.

II. Infrastructure & Regional Development

It is not seldom that government policy related to regional development, such as infrastructure development specifically built in less-developed regions, fail to meet the goal of narrowing the gap between developed and less-developed regions. By using the following two concepts, explain how such phenomena could occur.

a) Classical location theory (hint: you should focus on the difference between the postulate of the theory and the implicit assumption required for the postulate to hold)

b) Interregional multiplier concept. In your answer, use the following interregional social accounting matrix which reflects the typical case of many countries (Notes: Fact = factors, Inst = institution; Prod = production; Depr = depreciation)

Initial Year: Less-Developed Region (LDR) and Developed Region (DR) SAM Multipliers

		LDR				DR			
		1 Fact.	2 Inst.	3 Prod.	4 Depr.	5 Fact.	6 Inst.	7 Prod.	8 Depr.
LDR	1. Factors	2.34	1.33	1.91	1.40	0.17	0.17	0.18	0.19
	2. Institutions	4.46	4.65	3.73	2.74	0.34	0.33	0.35	0.38
	3. Production	2.15	2.13	3.07	2.25	0.28	0.27	0.29	0.31
	4. Depreciation	0.26	0.14	0.21	1.15	0.02	0.02	0.02	0.02
DR	1. Factors	0.85	0.80	0.84	1.22	2.75	1.69	2.14	2.13
	2. Institutions	1.65	1.55	1.63	2.36	5.13	5.23	4.14	4.12
	3. Production	2.07	1.95	2.05	2.97	4.26	4.10	5.20	5.18
	4. Depreciation	0.10	0.10	0.10	0.15	0.33	0.20	0.26	1.26

Current Year: Less-Developed Region (LDR) and Developed Region (DR) SAM Multipliers

		LDR				DR			
		1 Fact.	2 Inst.	3 Prod.	4 Depr.	5 Fact.	6 Inst.	7 Prod.	8 Depr.
LDR	1. Factors	2.51	1.49	2.01	1.61	0.20	0.19	0.19	0.25
	2. Institutions	5.51	5.71	4.52	3.61	0.44	0.42	0.42	0.55
	3. Production	2.44	2.40	3.25	2.59	0.32	0.30	0.30	0.40
	4. Depreciation	0.28	0.17	0.22	1.18	0.02	0.02	0.02	0.03
DR	1. Factors	1.01	0.97	0.96	1.29	3.06	1.99	2.44	2.39
	2. Institutions	2.04	1.96	1.94	2.61	6.05	6.19	4.94	4.85
	3. Production	2.11	2.02	2.00	2.69	4.31	4.16	5.09	5.00
	4. Depreciation	0.14	0.14	0.14	0.18	0.43	0.28	0.34	1.34

III. Regional Decentralization and Role of Institution

While policy is important, institution is no less important--in some cases even more important than policy--in explaining the outcome of regional development. In the case of decentralization policy, for example, the Institutional Model of Decentralization (IMD) has shown that given the widespread occurrence of 'local capture,' peoples' participation and the quality of local leaders—both reflect the institution--play a key role in determining the welfare outcome of the policy.

a) Explain what is 'local capture,' and describe the mechanisms how decentralization policy mired by 'local capture' affects the welfare outcome of the policy (use the necessary diagram)

b) Explain the multiple equilibria outcome in IMD, and show why for the welfare improvement the efforts to raise peoples' participation are more important than, say, attempts to inject more money or reduce poverty.