



Stockholm  
University

Department of Economics

**Course name:** International Economics  
**Course code:** EC2301  
**Examiner:** Anders Åkerman  
**Number of credits:** 7,5 credits  
**Date of exam:** Sunday 17 February 2013  
**Examination time:** 3 hours [09:00-12:00]

**Write your identification number on each paper and cover sheet (the number stated in the upper right hand corner on your exam cover).**

**Use one cover sheet per question.** Explain notions/concepts and symbols. If you think that a question is vaguely formulated, specify the conditions used for solving it. Only legible exams will be marked. **No aids are allowed.**

**Answer in Swedish or English.**

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The maximum number of credits is 99 (for answers on the exam) + 16 (for assignments). Credits correspond to grades as follows:

90 – 115	A
80 – 89	B
70 – 79	C
60 – 69	D
50 – 59	E
0 – 49	F

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Your results will be made available on your “My Studies” account ([www.mitt.su.se](http://www.mitt.su.se)) on March 8 at the latest.

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**Good luck!**

1. Explain the following concepts in 50 words maximum for each concept. (3 points per concept, i.e. maximum 24 points).

- a) Production Possibility Frontier (PPF).
- b) Heckscher Ohlin Theorem.
- c) Infant industry.
- d) Terms of trade.
- e) Trade diversion.
- f) Comparative advantage.
- g) Local content requirement.
- h) Gravity model of trade.

2. The car industry is a typical example of a monopolistically competitive market since it is characterised by large fixed costs, product differentiation and love of variety on behalf of consumers. Moreover, globalisation and integration of markets have brought substantial changes to the structure of production in this market. This question will ask you to analyse the global car market using the model of *monopolistic competition*. (Reminder: the assumptions in this model are that firms have a fixed cost of production and therefore experience internal economies of scale and that consumers wish to consume a variety of goods.)

- a) Using the model of monopolistic competition, derive a relationship (the “CC-curve”) between the number of firms in a market and the average cost per firm. Explain. (5 points)
- b) Derive a relationship (the “PP-curve”) between the number of firms in a market and the price that each firm charges. Explain. (5 points)
- c) Use your answer to a) and b) to find the equilibrium number of firms in a closed economy. Use the fact that there must be zero profits in the equilibrium. Explain. (7 points)
- d) Now, assume that the economy you have studied starts to trade with an identical neighbouring country and that the cost of trade is zero. Find the change that this brings to prices, costs and the number of firms. How does welfare change? Explain your answer. (8 points)

*THE EXAM CONTINUES ON THE FOLLOWING PAGE*

3. Consider a small country that decides to implement an export subsidy in a particular perfectly competitive industry.

- a) Using a graph, explain the effect on prices in the country. Also, explain the welfare effects through the producer surplus, consumer surplus and the government's budget. (10 points)
- b) What will the net effect on the country's welfare be? Explain. (5 points)
- c) Consider the case of a large country instead. How would your reply to a) and b) change if the country is large? Explain. (5 points)
- d) What will the effect on the country's terms of trade be (both for the case of a small and a large country)? (5 points)

4. The geographic distribution of economic activity is very uneven. One example of this is the existence of clusters: geographic areas characterised by agglomeration of a certain industry. In the policy debate, one often hears discussions of the benefits of clusters and how to attract clusters to a certain region. Generally, we often summarise the mechanisms that give rise to agglomeration into the notion of *external economies of scale*.

- a) Give three examples of economic mechanisms that can give rise to external economies of scale. Explain each example. (6 points)
- b) Give three examples of economic clusters in the world. For each example, explain which of the mechanisms in a) that you believe is especially important. (6 points)
- c) One can sometimes observe cases where one country has a large share of global production in an industry even though other countries appear to be better suited for production in this industry (i.e. the other countries may have lower wages and similar technology). How can external economies of scale explain this phenomenon? Explain using a graph. (7 points)
- d) Assume that two completely identical countries start to trade with each other in an industry which is characterised by external economies of scale. Where will firms in this industry locate in the long run? Explain. (6 points)