



Stockholm
University

Department of Economics

Course name: International Economics
Course code: EC2301
Examiner: Anders Åkerman
Number of credits: 7,5 credits
Date of exam: Tuesday 14 January 2014
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.

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

Your results will be made available on your “My Studies” account (www.mitt.su.se) on January 31 at the latest.

Good luck!

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

- a) terms of trade
- b) comparative advantage
- c) pollution haven
- d) internal economies of scale
- e) the gravity model
- f) corporate social responsibility
- g) median voter
- h) trade creation versus trade diversion

2. Current negotiations over a free trade agreement (the Trans-Pacific Partnership Agreement) between Japan and other countries around the Pacific Ocean have led to protests among Japanese rice farmers. Assume a simplified world where Japan and other countries only produce rice and cars. Furthermore, there are three production factors: capital, land and labor where capital is specific to producing cars, land is specific to producing rice while labor is required in the production of both goods. Finally, we assume that the autarky relative price of rice in terms of cars is higher in Japan than in other countries.

Use the specific factor model to answer the following questions.

- a) How will the relative price of rice in Japan change if trade is liberalized? Explain. (7 points)
- b) How will the allocation of labor between car and rice production in Japan change if trade is liberalized? Explain. (7 points)
- c) How will the *real* returns to land and capital in Japan change if trade is liberalized? Explain. (6 points)
- d) If one group is very worried about free trade, some might argue that the aggregate effect of free trade on Japanese welfare must be negative. Explain what the specific factor model predicts for the net effect of free trade on aggregate welfare in Japan. (5 points)

3. Assume that life is discovered on Mars and that it is possible to trade between Earth and Mars. People on Mars and Earth have identical preferences and consume only food and water. For each unit of food people on Earth have to work 4 hours but for each unit of water they need 2 hours. People need both of these goods to survive. Use the Ricardian model of trade to analyze the following questions.

a) What is Earth's relative price in autarky (i.e. before any trade with Mars is possible)? Explain. (5 points)

b) Now suppose that technology is developed such that trade is possible between Mars and Earth. People on Mars, however, need 8 hours to produce a unit of food and 8 hours to produce a unit of water. If there is trade between Earth and Mars, within what interval will the price be at which they trade? Explain. (5 points)

c) Explain the economic intuition for why it makes sense for Earth to trade with Mars even if Mars is slower at producing any of the two goods. (5 points)

d) However, people on Earth and Mars live quite far from each other so assume now that there is a 10% cost of trading in the sense that 10% of the food and water goes bad if it is traded instead of being consumed immediately. Can there still be trade between Earth and Mars? Explain. (5 points)

e) Now assume that 10% of the food and water goes bad if it is traded but also that people on Mars observe how people on Earth work and become equally skilled at producing both goods. How will they trade in this case? Explain. (5 points)

4. In 2013, the EU initiated an investigation that could have resulted in import tariffs on solar panels produced in China and sold in the EU. After some time, China announced that they considered imposing import tariffs on certain wine products that are exported from the EU to China.

Consider the following payoff matrix to China and the EU, respectively, under different trade policies:

		China	
		No import tariff	Import tariff
EU	No import tariff	25 / 25	30 / 5
	Import tariff	5 / 40	10 / 10

Explanatory note on table: If neither China nor the EU impose an import tariff, then both countries receive \$25m in social surplus. If China but not the EU imposes a tariff, then China receives \$30m while the EU receives \$5m. If the EU but not China imposes a tariff, then China receives \$5m while the EU receives \$40m. If both impose a tariff, then both receive \$10m.

- Given this payoff matrix, what trade policy would China and the EU choose if there was no possibility for the parties to negotiate? Explain. (7 points)
- If the EU and China could sit down and negotiate, and make credible commitments on future policies, what trade policy would be the outcome? Explain. (7 points)
- The fact that an individual country gains from imposing an import tariff goes against the conclusions of many theoretical models of international trade. Give three reasons that we have discussed in the course of why it might benefit a country to impose an import tariff. (6 points)
- Explain why the problem of *collective action* may cause the political process in a country to result in restrictions on trade even in cases when free trade would be optimal for a country's welfare? (5 points)