



Stockholm
University

Department of Economics

Course name: International Economics
Course code: EC2301
Examiner: Anders Åkerman
Number of credits: 7,5 credits
Date of exam: Saturday 15 February 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 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 March 7 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) external economies of scale
- b) intra-industry trade
- c) quota rents
- d) local content requirement
- e) vertical foreign direct investment
- f) Leontief paradox
- g) optimum tariff
- h) voluntary export restraint (VER)

2. When the Great Recession hit in 2007, many feared that several countries would resort to imposing import tariffs in sectors that were particularly weak.

a) Suppose that country A is a large country and that it imposes an import tariff on a good that it is importing. Show graphically how the import tariff affects the world price, the price in country A as well as consumer surplus and producer surplus in country A. Explain. (7 points)

b) What is the net effect on welfare in country A? Explain. (6 points)

c) What is the net effect on welfare in the rest of the world? Explain. (6 points)

d) Suppose that the rest of the world responds by introducing an export subsidy. What effect will this have on welfare in both country A and the rest of the world? Explain. (6 points)

3. The increase in income inequality, especially between workers with high versus low education, in many countries has partly been blamed on the increase in international trade. This question asks you to use the Heckscher Ohlin model to show how such a link between trade and income inequality can exist. For simplicity, assume also that there are two production factors: skilled and unskilled workers. Moreover, there are two countries: Japan and China. Finally, there are two sectors where one produces cars and one produces textiles. Both sectors use skilled and unskilled workers but the car industry is assumed to be intensive in skilled workers, i.e. it uses relatively more skilled than unskilled workers as compared to the textile industry.

a) Assume that Japan has a larger relative endowment of skilled workers, i.e. it is abundant in skilled workers. Explain using graphs how a move from autarky to free trade will affect *real* wages of skilled and unskilled workers in Japan and China. (12 points)

b) Now assume that we observe in reality that income inequality (as measured by the real wage of skilled workers divided by the real wage of unskilled workers) has increased in *both* Japan and China. What does this say about the notion that trade has caused the increase in inequality? Explain. (5 points)

c) Name and describe the main alternative explanation discussed in the course that can explain an increase in income inequality in both Japan and China? (8 points)

4. Many theories of trade assume that countries have to be different in some aspect in order for there to be gains from trade. However, for example Paul Krugman has shown that monopolistic competition and increasing returns to scale can generate gains from trade between two countries even if these countries are identical in all aspects.

a) Use the monopolistic competition model to show the long-run equilibrium levels of average cost, the number of firms and price under autarky (use the standard assumptions of this model in your answer). Explain your answer. (8 points)

b) Explain how this equilibrium changes when free trade is introduced between two identical countries. (8 points)

c) How does free trade affect welfare in these countries and through which channels does this happen? Explain. (9 points)