



Course name: International Economics
Course code: EC2301
Type of exam: Retake
Examiner: Anders Åkerman
Number of credits: 7.5 credits
Date of exam: Tuesday 27 August 2019
Examination time: 3 hours (13:00 – 16:00)
Aids: No aids are allowed.

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

Start each new question on a new answer sheet.

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.

The maximum number of credits is 99 (for answers on the exam) + 15 (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 Ladok account (www.student.ladok.se) within 15 working days from the date of the examination.

Good luck!



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

- a) Trade diversion.
- b) Trade creation.
- c) Agglomeration.
- d) Corporate social responsibility.
- e) Pollution haven.
- f) Horizontal foreign direct investment.
- g) Terms of trade.
- h) Free trade area versus customs union.

2. The *Heckscher-Ohlin model* is often used to understand the long-term effects of international trade on the income distribution. Imagine a simple economy where there are only carpenters and electricians working. They produce two goods: furniture and lamps. Both types of workers are needed in the production of both goods but the furniture industry uses carpenters intensively and the lamp industry uses electricians intensively. There are two countries: the Lowlands and the Highlands. In the Lowlands there are many more carpenters per electrician compared with in the Highlands. Use the *Heckscher Ohlin model* to answer the following questions.

- a) Suppose that there is no trade. Describe how the relative wages of carpenters and electricians are determined in the two countries. In which country is the relative wage of carpenters the highest? Explain your answer. (7.5 points)
- b) Describe how the relative goods prices of furniture and lamps are determined. Where are lamps relatively more expensive? Explain your answer. (7.5 points)
- c) Now assume that the two countries can trade. If we focus on the Highlands: how do relative wages of carpenters and electricians change? Who benefits in real terms and who loses? Explain your answer. (10 points)

THE EXAM CONTINUES ON THE FOLLOWING PAGE



3. One reason for creating international organizations that facilitate trade negotiations is the assumption that although all countries benefit if everyone lowers trade barriers, each country has an incentive to deviate and increase its tariffs. The following two questions focus on this issue.

a) Mention two ways discussed during the course how the overall welfare of a country can increase because of higher import tariffs. Explain each mechanism. (7.5 points for each mechanism)

b) Use the prisoners dilemma from game theory to explain why multilateral trade negotiations are needed if the mechanisms you mentioned in b) are important. (10 points)

4. The theory of comparative advantage is often highlighted as one of the most insightful theories in economics. This question asks you to apply the *Ricardian model* to a problem related to this.

Imagine that two villages, East and West, have different productivities in producing the two goods that matter in this economy: apples and pears. The Eastern village needs two workers to produce an apple and five workers to produce a pear. The Western village instead needs three workers to produce an apple and five workers to produce a pear.

a) Describe the relative prices of apples and pears in each village in autarky. Explain your answer. (4 points)

b) Describe the real wages in each village. Do this by calculating how much of either apples or pears a worker can consume. Explain your answer. (4 points)

c) How do relative prices of apples and pears change if we allow the villages to trade? Explain your answer. (4 points)

d) Describe how real wages change in each village when trade is allowed. Use the same method as in b). Explain your answer. (5 points)

e) Why is it that village East sees any point in trading with village West even though it is more or equally productive in producing both goods? (4 points)

f) Suppose now that village East is so large that its relative prices are not affected by trade with the West. Can there still be trade? If so, does anyone benefit from this? Explain your answer. (4 points)