Høgskolen i Østfold

EXAMINATION

Course code:	Course:	
SFB13509	**Topics in International Economics (10 ECTS)**	
Date: 04th of May 2012	Duration of exam: 09:00 – 12:00 (3 hours)	

Permitted sources:	Lecturers:
English – mother tongue dictionary Mother tongue – English dictionary Calculators	Ivar Bredesen Roswitha M. King

The examination:

The examination paper consist of 3 (three) pages inclusive this page. The exam consists of 4 (four) questions. Your task is to answer **all** four questions.

Please check that the examination paper is complete before you start answering the questions.

Date of announcement of the examination results: 28th of May, 2012.

Final Exam Questions (Topics in International Economics 2012)

Show all your steps. Show all your calculations. Explain all symbols that are not already explained in the exam question text. Label all items in graphs including the axes. Give an introductory and a concluding statement.

1. Absolute and comparative advantage and gains from trade

Two nations, A and B, each produce two goods, Wheat and Cloth. In the table below you are given the number of labour hours needed to produce one unit of the two goods:

	Wheat	Cloth
Nation A	9 hours	3 hours
Nation B	4 hours	2 hours

a) Explain, by referring to the numbers in the table, the difference between absolute and comparative advantage. Which nation has an absolute or comparative advantage in the production of which good/s?

b) Assume that nation B possesses 100 labour hours. Show the production and consumption possibilities in Nation B under autarky (no trade).

c) Assume now that nation A and B start trading with each other, and that the international relative price stabilises at $P_{wheat}/P_{cloth} = 2.5$. Show nation B`s consumption and production possibilities with trade. Does trade increase welfare in nation B?

d) Assume that due to an increased supply of Cloth from other countries, the relative price P_{wheat}/P_{cloth} changes to 3. How does this affect the gains from trade in nation A?

2. Intra-industry trade

a) Discuss what is meant by intra-industry trade.

b) How well do you feel the Heckscher-Ohlin model of international trade can explain intra-industry trade? Can other models be more relevant?

3. Import tariff

a) Assume that a small country imposes a specific tariff on imports of a certain good. Show how the tariff may affect efficiency and distribution of income in the country.

b) Which economically sound arguments can be raised in favour of tariffs or other protectionist instruments?

c) How would your results in a) be affected if the importing country instead is a large nation?

4) Law of One Price (LOOP)

Consider two countries, Brazil and Mexico. Brazil's currency is the *'real'* and Mexico's currency is the *'peso'*. Both countries are open economies. Both countries produce oranges. In Mexico, oranges sell for 10 pesos per pound of oranges. The exchange rate is 0.5 reals per peso, that is $E_{reals/pesos} = 0.5$. We will also be interested in the price of oranges in the USA and therefore the following information is of interest: The peso-US$ exchange rate is 10 pesos per US$, that is $E_{pesos/US\$} = 10$.

a) If LOOP holds, what is the price per pound of oranges in Brazil?

b) If LOOP holds, what is the price per pound of oranges in USA?

c) Now suppose the price of oranges in Brazil is 5.5 reals per pound of oranges. At the same time the price or oranges in USA is US$ 1.00 per pound. Based on this information check in which country (countries) LOOP holds. In both countries? Only in Brazil? Only in USA?

d) Does LOOP hold in the real world? What are the empirical findings?