

EXAMINATION

Course Code: SFB13509	Course: Topics in International Economics
Date: 12 May 2014	Duration: 9.00-12.00, 3 hours
Permitted Sources: Mother tongue - English - mother tongue dictionary Calculator	Lecturer: Joachim M. Thøgersen
<p>The examination set:</p> <p>The examination set consists of 3 pages, this page included. Please check that the examination papers are complete before you start answering.</p> <p>The examination consists of 5 questions. All questions must be answered.</p>	
<p>Date of announcement of the examination results: 3 June 2014</p> <p>The examination results will be made available on the <u>Studentweb</u> no later than two workdays after the announcement of the examination results (www.hiof.no/studentweb).</p>	

Question 1 (20 %)

Assume that the two countries Japan and Italy both produce the cars Nissan GTR and Ferrari F12. The only variable input is labor, and the following table shows the number of cars produced per week:

	Italy	Japan
GTR	140	100
F12	120	80

- Determine the trade pattern if you employ the theory of absolute advantage.
- Calculate the relative prices in autarky for both cars. Determine the trade pattern based on these prices and the theory of comparative advantage.
- What do we know about the international relative price on GTR?
- Assume that there are 5 workers in Italy that either can work in GTR production or F12 production. Draw the production possibilities frontier (PPF) for the two cars in Italy before trade.

Question 2 (25 %)

In the closed economy N they produce fish (F) and haircuts (H). Individuals in N are assumed to maximize utility subject to a budget constraint and in equilibrium: the relative price is equal to the marginal rate of substitution (MRS). That is, $P_F/P_H = MRS$, where P_F is the price on fish, and P_H is the price on haircuts.

- Assume that the firms in N will maximize income subject to the production possibilities. Show their optimal trade-off in a diagram where you measure F on the horizontal axis, and H on the vertical axis.
- Show the equilibrium in autarky in N. Is this situation Pareto-optimal?
- Assume that N opens up to international trade. It can be shown that N had a comparative advantage in fish. What do you know about the differences in relative prices due to these comparative advantages?
- Show and compare the autarky situation with the international trade situation for N in a diagram similar to the one you used in (a).
- Is the situation with international trade Pareto-optimal? Explain your conclusion.

Question 3 (20 %)

- (a) Explain the definitions of consumer surplus, producer surplus and welfare. Use a diagram with demand and supply curves to illustrate the definitions graphically.
- (b) Assume a small open economy that is in the market for chocolate. The autarky price is above the international world price. Show how consumer surplus, producer surplus and welfare are affected by free trade in such a situation.
- (c) Show the welfare effects of an import tariff.

Question 4 (15 %)

- (a) Give a definition of an exchange rate.
- (b) What is the difference between a fixed and a flexible exchange rate regime?
- (c) Explain shortly the meaning of uncovered interest parity.

Question 5 (20 %)

In Greece the unemployment rate is high and the macroeconomic activity is low. Assume that an IS-LM-(BP) model for an open economy is known. Show how an expansionary fiscal policy will affect the economy if the exchange rate is fixed.