

EXAMINATION

Course code: SFB13509	Course: Topics in International Economics – re-sit
Date: 05.01.2015	Duration 09.00 – 12.00
Permitted sources: Mother tongue – English and English – mother tongue dictionary Calculator	Lecturer: Joachim Thøgersen
<p>The examination: The examination papers consist of 3 pages, inclusive this page. Please check that the examination papers are complete before you start answering the questions.</p> <p>All questions should be answered.</p>	
<p>Date of announcement of the examination results: 27.01.2015</p> <p>The examination results will be made available on the Studentweb no later than two workdays after the announcement of the examination results (www.hiof.no/studentweb).</p>	

Please answer all questions

Question 1 (25%)

Theory of trade explains why nations gain by trading with each other instead of producing all goods self. Explain – using Ricardo model:

- a) What is meant by comparative advantage and which factors can explain comparative advantage
- b) Assume two countries: Home and Foreign, producing 2 goods: wine and cloth. Marginal productivity of labour is:

	<u>Home</u>	<u>Foreign</u>
Cloth	2	1/3
Wine	1	2/3

What trade pattern will this suggest according to Ricardo model? Explain why.

- c) Assume that home has labour resources of 100 units, and that the world market relative price $P_w/P_c = 1$. Home exports 100 units of the export good. Does home gain from trade? Explain and show it on the graph.
- d) Has Ricardo-model any relevance for the world trade today?

Question 2 (30 %)

In the closed economy NOTT (no to trade), they produce watches (K) and corn (M).

- (a) Explain the production possibilities frontier (PPF) for NOTT, and show it in a diagram where you measure M on the horizontal axis, and K on the vertical axis.
- (b) What is the marginal rate of transformation?
- (c) Assume that the individuals in NOTT maximize utility subject to a budget constraint. Derive the optimal trade-off for these individuals, and explain the optimality condition.
- (d) Assume that firms maximize income for a given technology, and that this equilibrium is known. Show the equilibrium in autarky in NOTT.
- (e) Is this situation Pareto-optimal?
- (f) Assume that NOTT opens up to international trade. It can be shown that NOTT had a comparative advantage in M. The relative price on M is given by P_M/P_K , where P_M is the price on corn, and P_K is the price on watches. Show and compare the autarky situation with the international trade situation for NOTT.
- (g) Use the figure in (f) to show how consumption, production, the trade pattern, and the welfare is affected by international trade.
- (h) Is the situation with international trade Pareto-optimal?

Question 3 (20 %)

In international trade theory, comparative advantages can be presented within standard trade theory or the Heckscher-Ohlin model. Explain shortly the differences between these theories.

Question 4 (25 %)

Sweden is nowadays in a situation with low activity and high unemployment. To stimulate the economy the government decides to use expansionary economic policy. Assume that the IS-curve and the LM-curve are known.

- (a) Explain the BP-curve and show how this curve can be included in an IS-LM-BP model. You can assume that capital markets are perfect.
- (b) Assume that Sweden has a fixed exchange rate. Show how an expansionary fiscal policy will affect the interest rate and the activity (production) in the country.