Final Exam
December 20, 2001

Answer all questions on these exam sheets. There are four questions of different weights, with a total of 68 points on the exam. Look ahead at the indicated point values and budget your time accordingly.

1. (10 pts.) Two countries, Axioma and Boobala, are initially in complete autarky. As it happens, both countries have currencies that are called the "dollar," which we will call the A-dollar (A$) and the B-dollar (B$). Only two goods are produced and consumed, xams and yams (xams are all-purpose sheets of a fabricated material that are used for clothing, housing, and non-electronic testing of students in courses on international trade policy; yams are food). In autarky, the prices of xams and yams in the two countries are

	Axioma	Boobala
Xams	A$2.00	B$0.50
Yams	A$3.00	B$1.50

a. (2 pts.) Which country has a comparative advantage in xams? Which in yams? (Circle one in each row.)

Xams: Axioma Boobala both neither

Yams: Axioma Boobala both neither

b. (2 pts.) Suppose that these two countries now open up to free trade with each other (and no one else) exchanging both goods and currencies. Suppose also (perhaps for this part only) that producers continue to be able to produce the goods at the prices above. What are the limits on the possible exchange rate?

The B$ will be worth *no less* than __________ A$,

and *no more* than __________ A$.

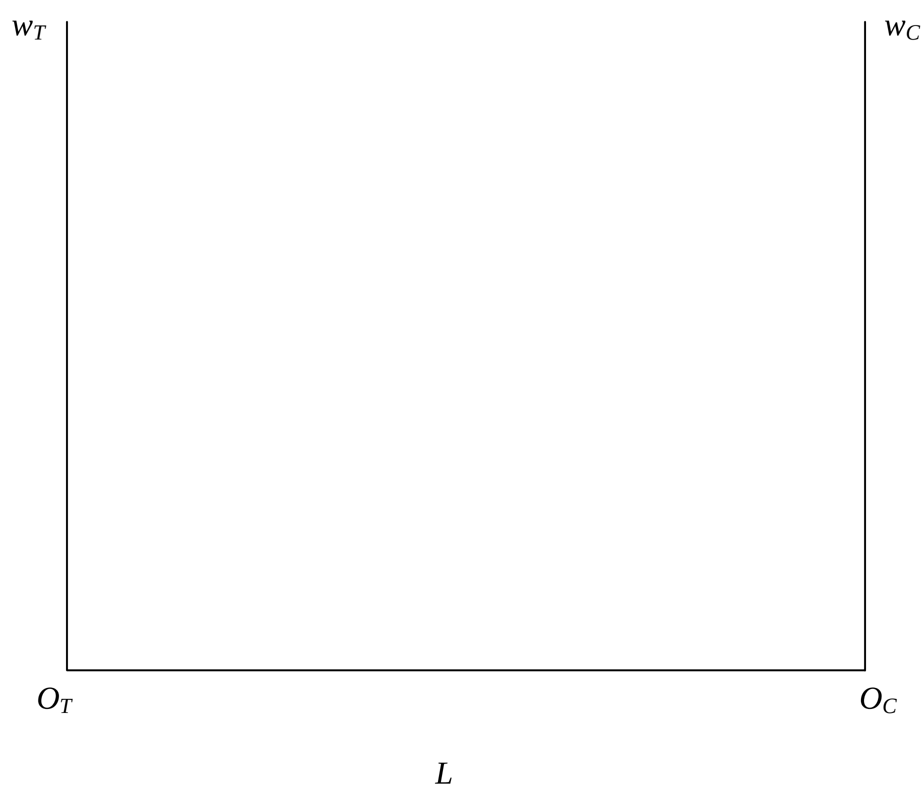
c. (4 pts.) Suppose that you were now told that these countries have the technologies of a Ricardian Model. Which patterns of specialization would then be possible? That is, each row of the table on the next page has "yes" for each good that ***is*** produced in each country. Place a check mark (✓) in the last column of each row that ***is*** possible for these countries in a Ricardian Model (with the autarky prices shown above).

	Axioma produces		Boobala produces		Possible?
	Xams	Yams	Xams	Yams	
1.					
2.	yes				
3.		yes			
4.			yes		
5.				yes	
6.	yes	yes			
7.	yes		yes		
8.	yes			yes	
9.		yes	yes		
10.		yes		yes	
11.			yes	yes	
12.	yes	yes	yes		
13	yes	yes		yes	
14.	yes		yes	yes	
15.		yes	yes	yes	
16.	yes	yes	yes	yes	

d. (2 pts.) Now suppose instead that the appropriate model to describe these same countries is the Heckscher-Ohlin Model, not the Ricardian model. Which pattern (or patterns) of specialization that were *not* possible in a Ricardian Model now *are* possible, if any? (Use the numbers of the rows above to answer in the space below.)

2. (14 points) A small open economy produces both computers, C, and textiles, T, both of which employ both capital and labor. In the short run, although labor is perfectly mobile between the sectors, capital is not. Instead, the capital that is initially installed in the computer industry is of no value outside it, and the same is true for capital in the textile industry.

   a. (4 points) On the axes below, illustrate an initial equilibrium for this economy facing initial world prices of the goods, P_{C0}, and P_{T0}, with free trade. Identify and label in your figure the initial amounts of labor employed in both sectors, L_{C0}, and L_{T0}, and the initial wages of labor in both sectors, w_{C0}, and w_{T0}.



   b. (4 points) Suppose now that the country is initially exporting computers and importing textiles, and that it now levies a tariff on imports of textiles. Show how the curve or curves in the figure change as a result, and indicate in the figure the changes in the allocation of labor and the wages paid in the two industries.

c. (4 points) How does this tariff affect the payments to the capital that is installed in the two industries? That is, do owners of capital in computers gain or lose from the tariff on textiles, and do owners of capital in the textile industry itself gain or lose? You may answer this by referring to the above figure, if you wish, or you may state and explain your result in some other way.

d. (2 points) Assume now that computers are relatively capital intensive and textiles are relatively labor intensive. In contrast to the results above, suppose that capital, as well as labor, is now perfectly mobile between sectors, so that this is the Heckscher-Ohlin Model. Without doing any formal analysis, explain how your answers to part (c) would change.

3. (24 pts.) You have been hired as an economic consultant to the tiny country of Malibubu, and, because it has wonderful beaches, you've accepted the job even though you know nothing else about the country, its economy, or even its language. Upon arrival, and before you can get to the beach, your hosts ask you to analyze the following situation: their economy is producing 48,000 tons of something they call yummigoop and importing 10,000 tons of it. The domestic price of yummigoop, they tell you, is ☺2.40 per ton (☺ is their currency), while it can be imported from abroad for ☺2.00 per ton. They say that the price difference is due to their policy of deterring imports using a "qrshme," but you don't want to admit that you don't know what that means. They also say that, without the qrshme, Malibubu would import 24,000 tons of yummigoop.

   a. (12 pts.) Assuming that the qrshme is in fact an *ad valorem* tariff, use a simple linear supply and demand model to work out the effects of **removing** it on the welfare of suppliers, demanders, government, and this tiny country as a whole. For this purpose, since you don't know otherwise and you want to get to the beach, assume that the elasticity of domestic supply is unity (1.0). Show your work, including your diagram, and then record your answers in the table at the top of the next page.

Effects of removing the qrshme	
Domestic suppliers gain or lose:	
Domestic demanders gain or lose:	
The Malibubu government gains or loses:	
The country of Malibubu gains or loses:	

b. (2 pts.) How would your answers to part (a) be different if the tariff were specific instead of *ad valorem*?

c. (4 pts.) How would your answers to part (a) be different if you knew that the elasticity of domestic supply were larger than one?

d. (2 pts.) You are now told that a qrshme is an import quota. Assuming that the quota rights are given away free to foreigners, how would your answers to part (a) be different?

e. (2 pts.) You are now told that quota rights are *not* given to foreigners, but are auctioned off in a competitive market. The revenues from the auction, however, are given to domestic producers of yummigoop. Again, how would your answers to part (a) be different?

f. (2 pts.) Finally, you learn that even though Malibubu is a tiny country, it is one of the very few countries in the world that consume yummigoop, so that your small-country assumption was not justified. How would this change your last answer (in part (e)) for the effect on the welfare of the country as a whole?

4. (20 pts.) In the news on December 8, 2001, the International Trade Commission recommended that President Bush impose tariffs of between 20 and 40 percent on most imports of steel into the United States for a period of up to four years, the purpose being (according to the *Financial Times*) "to give the steel industry time to consolidate, restructure and restore itself to profitability." Write an essay describing both the causes and the effects of this recommendation, being sure to touch on at least the following issues:

    a. What reason or reasons provide the legal justification for this recommendation, and under which provision of U.S. trade law?

    b. Does this recommendation appear to be consistent with, or a violation of, the rules of the World Trade Organization?

    c. Who will benefit and who will be hurt, both within the United States and elsewhere, from these tariffs if they are imposed?

    d. Are there other policies that you would recommend as better than these tariffs for serving the same purpose?

(Use this space to continue your answer to question 3.)

(Use this space, if necessary, to continue your answer to question 3.)