Final Exam
December 22, 2009

Answer in blue book. Use the indicated point values as a guide to how extensively you should answer each question. Look ahead and budget your time accordingly. The exam has a total of 60 points.

1. (8 points) The Wall Street Journal recently quoted USTR Ron Kirk as saying that the Doha Round "is like a cricket match. You don't know the score and it takes a long time, but it does end, and there is a winner." Discuss (not the part about cricket, but the rest).

2. (7 points) Apply the analytical tools (diagrams) of the standard trade model to the assumptions of the Heckscher-Ohlin (i.e., factor proportions) trade model to determine the effect on the terms of trade of a large capital-abundant country if it experiences an increase in its endowment of capital (other factor endowments of both it and the other country remaining unchanged). That is, will its terms of trade improve or worsen, and why?

3. (8 points) Answer the following questions regarding the gains from trade

   a. Illustrate the gains from free trade in the standard trade model. In that model, is it possible for a country to be made worse off by free trade, compared to autarky?

   b. How can the presence of increasing returns to scale cause a country to be made worse off by trade? Explain in words and illustrate in a diagram an example of how this could occur?

4. (4 points) Evaluate the following argument, using tools of analysis as appropriate:

   "The injury test for safeguards protection is redundant and therefore should be unnecessary. If there is an increase in imports in an industry, then that increase must necessarily cause injury to domestic suppliers."

5. (6 points) Write a short essay explaining the current US program of Trade Adjustment Assistance (TAA), including the following

   a. Reasons why a special program of assistance for trade-displaced workers is appropriate.

   b. The sorts of benefits that the program provides to workers.

   c. The meaning of, and rationale for, Alternative Trade Adjustment Assistance.

6. (11 points) The figure below shows domestic demand, D, and marginal cost of production, MC, in an industry in a small economy that faces a fixed world price P^W. Reproduce the figure in your blue book and then identify the quantities specified below. Since there are a large number of these, I suggest that for clarity you label quantities in your figure Q_1, Q_2, etc., and for parts (a)-(d) just write things like $S^C=Q_1$, $D^C=Q_2$, etc. Part (a) is done for you, to illustrate.

   a. Quantities produced domestically, S^C, demanded domestically, D^C, and exported or imported, X^C or M^C, if the domestic industry contains many perfectly competitive firms and trade is free.

      Ans: $S^C = Q_1$

      $D^C = Q_2$

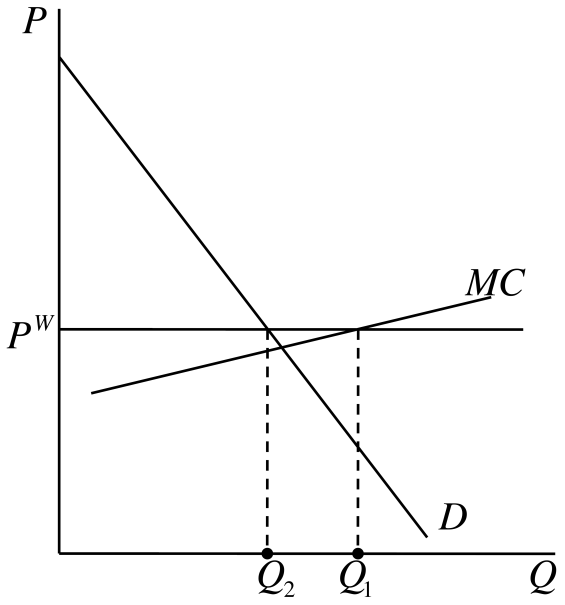
      $X^C = Q_1 - Q_2$

   b. Those same quantities, S^F, D^F, and X^F or M^F, if there is only a single domestic producer and trade is free.

   c. Those same quantities, S^T, D^T, and X^T or M^T, if there is only a single domestic producer and there is a prohibitive import tariff.

   d. Those same quantities, S^A, D^A, and X^A or M^A, if there is only a single domestic producer, there is a prohibitive import tariff, and the producer, threatened with an anti-dumping duty, decides not to export.

   e. Identify in the figure how you would decide whether the firm in part (d) would be better off not exporting, or better off exporting without dumping.



7. (16 points) Consider an industry in a small open economy that produces less than is demanded at the world price, which is $50 per unit. It therefore imports the good. Suppose that production of this good causes an external benefit to residents of the country that we know to be worth $20 per unit produced, but that producers of the good cannot charge for this. Maybe it smells good when it is produced.

    a. Show the effects of a 40% tariff on imports of this good, assuming that conditions are such that, while the tariff causes quantities supplied and demanded both to change, it does not eliminate imports completely. That is, show and identify in a supply-and-demand diagram the effects of the tariff on

        i. suppliers of the good,
        ii. demanders of the good,
        iii. government,
        iv. the residents who benefit from the externality, and
        v. the country as a whole (i.e., all of the above)

    b. Does the country as a whole necessarily lose from this tariff? Does it necessarily gain?

    c. Would your answer to (b) be any different if you knew that the supply elasticity was +1.0 and the demand elasticity was –1.0? Why? (This is hard. Don't spend time on it if it isn't obvious.)

    d. Now show the effects, starting again from free trade, of a production subsidy of $20 per unit produced, on suppliers, demanders, government, residents-via-the-externality, and the country as a whole.

    e. Does the country as a whole necessarily lose from the subsidy? Does it necessarily gain?