

**Examination
for the lecture
“International Trade”**

Preliminary Remarks:

- **Time:** 2 hours.
 - **Aids:** no aids are allowed, except a bilingual dictionary.
 - **Language:** English. Answers in German are possible for students who are registered in German-speaking programmes of the University.
 - **Structure:** 4 questions (1,2,3,4). Each question is to be answered using standard tools of economic reasoning. Each question is weighted equally and consists of three parts. In each question, a maximum of 30 points can be reached. The total number of points is 120.
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Question 1:

Assume a standard trade model with two countries, two goods and two factors of production. Show graphically and explain verbally

- (a) how an international income transfer affects the structure of trade and production as well as the terms-of-trade;
- (b) how biased growth affects the allocation of resources of the growing country at **given** world market prices;
- (c) how biased growth affects the terms-of-trade of the growing country. Consider also the case of immiserizing growth: how is it defined and how relevant is it in practice?

Question 2:

International trade within industries (“intra-industry trade”) can be explained by scale economies and product differentiation.

- (a) Show – algebraically, graphically and verbally – in a model of monopolistic competition how economies of scale and product differentiation interact.
- (b) Show graphically and explain economically, how the move from autarky to trade works in this model. Explain why, even with trade, the economy does not produce at the minimum of average cost.
- (c) A theoretical model is one thing, reality is another one. How realistic is the model that you used in parts (a) and (b)? Explain your answer.

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Question 3:

A country introduces an import tariff on good x. To analyze the effects of this tariff, use an appropriate partial equilibrium model.

- (a) Choose a model of a large country with perfect competition. Show graphically and explain verbally how the tariff affects prices, production and consumption as well as the welfare of the country. Use the concepts of consumer and producer surplus.
- (b) Choose a model with the presence of monopoly power. Show graphically and explain verbally how an import tariff affects monopoly power.
- (c) Compare the effects of an import tariff and an import quota. Do this for the case of perfect competition (part (a) above) and in the presence of monopoly power (case (b) above). Which one – import tariff or import quota – fares better in terms of limiting monopoly power, and why?

Question 4:

The government of a country decides to levy a tariff on imports of good x. An economic advisor to the government vaguely explains the rationale of this policy in the following way: “The protection is a temporary measure. It is to last only until the protected import-competing industry has grown into a size that makes it internationally competitive.”

- (a) Explain what precise economic logic may be behind the advisor’s argument.
- (b) What do you think about his argument? If his policy goal makes sense at all, can you think of more reasonable policies to achieve this goal?
- (c) Apply the economic logic from part (a) to a typical case of [i] a developing country and [ii] an industrialized country. What do you think about the past records of import-substitution policies, both in developing and industrialized countries?