

**Examination  
for the lecture  
"International Trade"  
(20026)**

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**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:**

In a Ricardo model with two countries (Home and Foreign), two goods (wine and cheese) and one factor of production (labour), a country specializes in the production of the good that it produces with a comparative cost advantage.

- (a) "Trade leads to gains for all." Show graphically that this statement is true. Give a verbal explanation of its economic rationale.
- (b) "Trade is an efficient form of indirect production." Show algebraically that this statement is true.
- (c) Assume now that there are more than two goods, but still two countries and one factor of production. Show graphically and explain verbally how the pattern of trade and specialization then looks like.

**Question 2:**

Assume a standard trade model with two countries, two goods and two factors of production. Show graphically and explain economically how and why the terms of trade are affected by

- (a) an international income transfer,
- (b) biased growth in one of the two countries,
- (c) a tariff on imports in one of the two countries.

**Question 3:**

A country introduces an export subsidy on its export good  $x$ . To analyze the effects of this subsidy, use an appropriate partial equilibrium model.

- (a) Choose a model of a large country. Show graphically and explain verbally how the export subsidy affects price, production and consumption of good  $x$  as well as the welfare of the country. Use the concepts of consumer and producer surplus.
- (b) Now choose a model of a small country. Show graphically and explain verbally in what respects the results differ from those in part (a).
- (c) "An export subsidy is a gift to the rest of the world. In contrast, an import tariff is a form of stealing." Evaluate this provocative statement in the light of partial equilibrium analysis for a large country.

**Question 4:**

The government of a developing country decides to levy a tariff on imports of good  $x$ . An economic advisor to the government 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 lie behind the advisor's argument.
- (b) Evaluate the advisor's argument in terms of alternative options to correct market failures. Distinguish between first- and second-best solutions.
- (c) What do you think about the past records of import-substitution policies in developing countries?