

**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. 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 (Home, Foreign), two goods (cloth, wine) and two factors of production (labour, land). Assume that Home is the country that exports cloth and imports wine. Show graphically and explain verbally how the terms-of-trade are affected by

- (a) an international transfer of income from Home to Foreign;
- (b) a biased growth toward wine in Home;
- (c) an export subsidy for cloth in Home.

In your economic reasoning, distinguish between normal and extreme cases, including “immiserizing growth” and the “Metzler paradox”.

**Question 2:**

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

- (a) Show – graphically and explain economically – 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.
- (c) Assume that a minimum of average cost exists as marginal cost rise above average cost at a certain output. Does the industry produce at the minimum average cost in the long run? If so, why? If not, why not?

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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 **general** equilibrium model with two goods. Assume that the country is small, that the tariff is ad valorem, and that tariff revenue is fully redistributed to domestic consumers.

- (a) Show graphically – in a two-goods framework with a transformation curve and with indifference curves – how the tariff affects prices, production and consumption as well as the welfare of the country.
- (b) Explain your results from part (a) verbally, using standard economic logic.
- (c) Assume now a large country. Explain how the results change.

**Question 4:**

In the last six decades, world-wide tariff levels have gone down massively. This happened in the framework of the GATT (followed by the WTO).

- (a) Explain how, historically, this has been achieved. Why has the current Doha-Round so far not been completed successfully?
- (b) The reduction of world-wide tariff levels is widely regarded as a great political and economic success. Why is this so? Do you agree?
- (c) The GATT is based on some fundamental principles. Explain these and their working. Explain also the advantages and the drawbacks of multilateral vs. bilateral negotiations.
- (d) The GATT allows so-called preferential trade agreements, notably free trade areas and customs unions. Define these. Give examples. What do you think of them in terms of “trade creation” and “trade diversion”?
- (e) The WTO has established a dispute settlement procedure. Explain how it works. Has it been a successful instrument to reduce the damage and the potential of trade conflicts?