## AFRICA UNIVERSITY

*(A United Methodist-Related Institution)*
*"Investing in Africa's Future"*

**COURSE TITLE:** **MEC302 INTERNATIONAL ECONOMICS**

**SEMESTER:** **ONE**

**EXAMINATION:** **FINAL EXAMINATION- NOV 2014**

**LECTURER:** **MR T. MASESE**

**TIME:** **3 HOURS**

## INSTRUCTIONS

Answer **ALL Questions from this paper**

Start **each** question on a new page in your answer Booklet.

The marks allocated to **each** question are shown at the end of the section.

**Show all your workings.**

Credit will be awarded for logical, systematic and neat presentations.

**Question One**

a. Suppose that the production of $1 million worth of steel in South Africa requires $100,000 worth of taconite. Nigeria's nominal tariff rates for importing these goods are 20 percent for steel and 10 percent for taconite. Given this information, calculate the effective rate of protection for Nigeria's steel industry **(3 marks)**

b. What factors influence the size of the revenue, protective, consumption, and redistributive effects of a tariff? **(5 marks)**

c. Assume that Zimbabwe is a small country with two car assembly companies, namely Willovale Mazda Motor Industry and Quest Motors. In autarky the equilibrium price for cars in Zimbabwe is determined by the intersection of its demand and supply schedules. At the price of $9500, the quantity supplied is 50 units and the quantity demanded is 50 units. Now suppose that the economy is opened to foreign trade and that the world car price is $8,000, which is less than the domestic price. With free trade demand for cars is 80 units and the number of cars produced domestically is 20 units. Under free trade, the domestic car industry is being damaged by foreign competition. Industry sales and revenues are falling, and workers are losing their jobs. Suppose management and labor of the two companies unite and convince the government to levy a protective tariff of $1000 on car imports. Domestic production increases by 20 units, whereas domestic consumption falls by 20 units.

   i. Sketch the above information on demand and supply framework. What is the level of imports before and after the tariff **(6 marks)**

   ii. Calculate, in monetary terms the revenue effect; redistributive effect; protective effect and consumption effects of the tariff. How much is the dead weight loss due to the tariff? What is the net national welfare loss/ gain due to the tariff **(10 marks)**

## Question Two

a. Outline and explain the 3 main types of tariffs used by governments to limit the amount of imports into the country. What are the main advantages and disadvantages of each type of tariff? **(12 marks)**

b. Outline and discuss the main arguments put forward for protectionist policies **(13 marks)**

## Question Three

a. Suppose the US is a large country and it imports cars from Japan. Line $S_d$ represents the domestic supply schedule, and line $D_d$ depicts the home demand schedule. Autarky equilibrium occurs at point Eat a price of $9600 and quantity of 70 units. With free trade, the importing nation faces a total supply schedule of $S_{d+w}$ which shows the number of cars that both domestic and foreign producers together offer domestic consumers.

Cars in Japan cost $8000 per unit. The total supply schedule is upward sloping because the foreign supply price is not a fixed constant but depends on the quantity purchased by the US since it is a large buyer of the product. With free trade, our country achieves market equilibrium at point F. The price of autos falls to $8,000, domestic consumption rises to 110 units, and domestic production falls to 30 units. Suppose that the importing nation imposes a specific tariff of $1,000 on imported autos. By increasing the selling cost, the tariff results in a shift in the total supply schedule from $S_{d+w}$ to $Sd_{+w+t.}$ Market equilibrium shifts from point F to point G, while product price rises from $8,000 to $8,800.

    i.    Show the above information on a graph **(6 marks)**

    ii.    By how much will the consumer surplus fall? Calculate the redistributive effect, consumption effect, protective effect, domestic revenue effect and the terms of trade effect of this tariff. **(9 marks)**

b. Outline the main economic and political reasons for regional and global integration

c. Write brief notes on **five** of the following:

    **i.**    Free trade area (FTA) (ii) Customs Union    (iii) Common Market (iv) Economic Union  (iv) Customs Union (v) Trade Creation (vii) Trade Diversion **(10 marks)**

**Question 4**

a. Write a briefly advocating or criticizing each of the following policy positions:

    i.    The government should not allow imports if foreign firms are selling below their costs of production (a phenomenon called "dumping") **(2 marks)**

    ii.    The government should temporarily stop the import of goods for which the domestic industry is new and struggling to survive **(2 marks)**

    iii.    The government should not allow imports from countries with weaker environmental regulations than ours **(2 marks)**

b. Assume a classical world of two goods and two countries where labor is the only input. One day of labor will produce the following amounts of output in each country:

| Country | Cloth (meters) | Wheat (kilograms) |
|---|---|---|
| Metropolitano | 20 | 30 |
| Ruritania | 5 | 15 |

    i.    What pattern of comparative advantage exists? **(2 marks)**

    ii.    Ruritania has an absolute disadvantage in each good. Nevertheless, it can still gain from trade. If the equilibrium exchange ratio is two bushels of wheat per 1 yard of cloth, explain how Ruritania gains from trade **(2 marks)**

    iii.    If Ruritania discovers a new way of producing cloth and its labor productivity rises to 10 yards per day, how does that affect the potential gains from trade? **(2 marks)**

c. Suppose that a (small) country is an importer of good X, for which the current world price is $8. At that price with free trade, home producers are supplying 500 units of good X and the country is importing 300 units. It is now rumored that a 10 percent import duty will be imposed on good X. Estimate the welfare impacts that would occur with such a tariff, given that the elasticity of demand by consumers for good X is -2.0 and that the elasticity of home supply is 1.6 **(9 marks)**

d. Briefly explain the specie-price flow mechanism **(4marks)**

**END OF PAPER**