



“Investing in Africa’s Future”

FACULTY OF MANAGEMENT AND ADMINISTRATION

COURSE: MEC302 INTETRANATIONAL ECONOMICS (TRADE)

SEMESTER 1: FINAL EXAMINATION- NOVEMBER 2013

LECTURER: MR T. MASESE

TIME: 3 HOURS

INSTRUCTIONS

Answer Question One and any other Two Questions from this Paper. Total marks 75

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

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

Please show all your workings since marks will be awarded for correct workings.

Question One

- Describe a specific tariff, an ad valorem tariff, and a compound tariff. What are the advantages and disadvantages of each? **(8 marks)**
- Discuss the major economic and non-economic arguments for trade restrictions **(7 marks)**
- You are given the following information about copper in the European Union:

	<i>Situation with tariff</i>	<i>Situation without tariff</i>
World price	1.50 euros per kg	1.50 euros per kg
Tariff (specific)	0.15 euros per kg	0
EU domestic price	1.65 euros per kg	1.50 euros per kg
EU consumption	200 million kg	230 million kg
EU production	160 million kg	100 million kg

- Draw a supply–demand diagram on the basis of these data and indicate imports with and without the tariff **(2 marks)**.
- Calculate the following explaining briefly the meaning of each calculation.
 - The gain to EU consumers from removing the tariff **(2 marks)**
 - The loss to EU producers from removing the tariff **(2 marks)**
 - The loss of tariff revenue to government when the tariff is removed **(2 marks)**
 - The net gain or loss to the EU economy as a whole. What implicit assumptions do you make in reporting a net result? **(2 marks)**

Question Two

- Suppose that the free trade price of a good is \$12 and a 10 percent ad valorem tariff is put in place. As a result, domestic production in a small country rises from 2,000 units to 2,300 units and imports fall from 600 units to 200 units. Who are the winners and losers? What is the size of their gains and losses? What is the net effect on society? **(6 marks)**
- Write a briefly advocating or criticizing each of the following policy positions:
 - The government should temporarily stop the import of goods for which the domestic industry is new and struggling to survive **(2 marks)**
 - The government should not allow imports from countries with weaker environmental regulations than ours **(2 marks)**
- An article in *The Sunday Mail* (June 26, 2012) about sugar beet growers explained that “the US Government props up domestic sugar prices by curtailing imports of lower-cost sugar. Producers are guaranteed a ‘market stabilization price’ of \$0.22 a pound, about \$0.09 higher than the current world market price.” The government maintains the higher price by imposing an import quota.
 - Illustrate the effect of this quota on the U.S. sugar market. Label the relevant prices and quantities under free trade and under the quota. **(3 marks)**
 - Analyze the effects of the sugar quota using the tools of welfare analysis **(5 marks)**

- d. 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

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

Question Three

- Free-trade areas are far more common than customs unions. Briefly explain the following types of preferential trade blocs' concepts: free trade area, customs union, common market, economic union, monetary union and political unions. Give two political and two economic arguments for and against regional integrations? **(10 marks)**
- What are the two primary economic and four political arguments that critics use against free trade? **(6 marks)**
- 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)**

Question Four

- The following table shows the hours of labor required to produce 1 unit of each commodity in each country

	<i>Wheat</i>	<i>Clothing</i>
South Africa	3 hrs	2 hrs
Zimbabwe	4 hrs	8 hrs

Which country has a comparative advantage in wheat? In clothing? Why? If trade takes place between the South Africa and the Zimbabwe at a barter price of 1 clothing for 2 wheat (or 1 wheat for 1/2 clothing), why does each country gain from trade? Explain your answers **(5 marks)**

- Suppose that India has a trade surplus with Spain. Explain how the price-specie flow mechanism would work and bring about balanced traded between the two countries given sufficient adjustment time. What are the critical assumptions of the price-specie flow

mechanism? What happens to the trade balance in India if the demand for trade goods is inelastic? Why? **(7 marks)**

- d. Define the following INCOTERMS and explain the obligations of the buyer and seller under each term:
- i. Free on Board (FOB) **(2 marks)**
 - ii. Cost Insurance and Freight (CIF) **(2 marks)**
 - iii. Delivered Duty Paid (DDP named place) **(2 marks)**
- e. How did Smith's views on international trade differ from those of the mercantilists? **(7 marks)**

Question Five

- a. Briefly explain some of the major sources of comparative advantages for some countries involved **(5 marks)**
- b. How does the Heckscher-Ohlin theory differ from Ricardian theory in explaining international trade patterns? **(3 marks)**
- c. Assume the nation of Australia is "small," unable to influence world price. Its demand and supply schedules for TV sets are shown in the following Table. Plot the demand and supply schedules on the same graph.

Price of TVs	Quantity Demanded (000)	Quantity supplied (000)
\$500	0	50
400	10	40
300	20	30
200	30	20
100	40	10
0	50	0

- a. What are the equilibrium price and quantity? Calculate the value of Australian consumer surplus and producer surplus at equilibrium **(4 marks)**
- b. Under free-trade conditions, suppose Australia imports TV sets at a price of \$100 each. Determine the free-trade equilibrium, and illustrate graphically. **(4 marks)**
- c. How many TV sets will be produced, consumed, and imported under free trade? **(3 marks)**
- d. Calculate the dollar value of Australian consumer surplus and producer surplus with free trade **(3 marks)**
- e. To protect its producers from foreign competition suppose the Australian government levies a specific tariff of \$100 on imported TV sets. Determine and show graphically the effects of the tariff on the price of TV sets in Australia, the quantity of TV sets supplied by Australian producers, the quantity of TV sets demanded by Australian consumers, and the volume of trade. **(4 marks)**
- f. Calculate the reduction in Australian consumer surplus due to the tariff induced increase in the price of TV sets. **(2 marks)**
- g. Calculate the value of the tariff's consumption, protective, redistributive, and revenue effects (i.e. welfare effects of the tariff on producers, government, consumers and the nation). What is the amount of deadweight welfare loss imposed on the Australia economy by the tariff? **(5 marks)**

END OF PAPER