



"Investing in Africa's Future"

FACULTY OF MANAGEMENT AND ADMINISTRATION

MEC302 INTERNATIONAL ECONOMICS (TRADE)

END OF FIRST SEMESTER EXAMINATIONS

NOVEMBER/DECEMBER 2016

LECTURER: T MASESE

DURATION: 3 HRS

INSTRUCTIONS

Answer ALL questions in this paper

Total possible mark is.....

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. Explain the economic basis of supporting free trade (7 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) |
|--------------|----------------|-------------------|
| Zimbabwe | 40 | 60 |
| South Africa | 10 | 30 |

- i. What pattern of comparative advantage exists? (2 marks)
- ii. Zimbabwe 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 Zimbabwe gains from trade (2 marks)
- iii. If Zimbabwe 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. Discuss how the product life cycle theory explains the changing patterns of trade and the dynamic nature of comparative advantage between countries. What are the major assumptions of this theory (10 marks)
- d. List and explain the six main forms of regional blocs. Briefly discuss the economic and political benefits of regional integration (12 marks)

Question Two

- a. With the aid of a demand/supply illustrate how a subsidy can turn an imported product into an exported product (2 marks)
- b. Briefly explain the difference between anti-dumping duty and a countervailing duty (2 marks)
- c. Despite the power of the free-trade argument, however, free-trade policies meet major resistance among various countries because of import competition. Evaluate the arguments in favor of protectionisms. What measures might be used to provide effective protection? (10 marks)
- d. What is an import tariff? Outline the 3 main forms of tariffs and clearly explain the differences between a protective tariff and a revenue tariff (6 marks)
- e. Briefly explain any four non-tariff trade barriers used to protect import competing industries (6 marks)
- f. 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 **(5 marks)**

Question Three

- What is an export subsidy? Describe any 7 subtle ways in which governments can subsidize their exports to avoid detection by importing countries **(9 marks)**
- Briefly explain the effects of a subsidy on;
 - Amount of exports and production in the exporting country **(2 marks)**
 - Prices paid by local and foreign consumers or buyers of the exported product **(2 marks)**
 - The exporting country's net national wealth **(2 marks)**
- With a free trade price of \$100, Mauritius, a small country, exports 90 million steel pipes. If the country, instead offers an export subsidy \$20 per unit exported, revenue per unit exported rises to \$120, and the exporting firms must receive this amount as the selling price from domestic buyers as well. Domestic production rises from 160 to 190 million, domestic consumption falls from 70 to 50 million.
 - What is the amount of the country's exports before and after the subsidy? **(2 marks)**
 - Illustrate the above information using the demand/supply framework for Mauritius. **(2 marks)**
 - Calculate the effects of the subsidy on the local consumers, producers, cost of the subsidy to the government and the net national welfare **(6 marks)**

Question Four

- Briefly explain what dumping is and identify its main forms. What are the effects of dumping on the importing country's consumers and import-competing industry? How can the importing country react to dumping **(10 marks)**
- You are given the following information about chicken meat in South Africa, a small country:

| | Situation With Tariff | Situation Without Tariff |
|----------------------|-----------------------|--------------------------|
| World Price | \$2.00 per kg | \$2.00 per kg |
| Tariff (ad-valorem) | 20% | 0 |
| Domestic Price | \$2.40 per kg | \$2.00 per kg |
| Domestic Consumption | 220 million kg | 250 million kg |
| Domestic Production | 180 million kg | 120 million kg |

- Draw a supply-demand diagram on the basis of these data and indicate imports with and without the tariff **(3 marks)**.
- Calculate the following explaining briefly the meaning of each calculation.
 - Redistributive effect, revenue effect, consumption effect and the productive effect of the tariff when the tariff is removed **(8 marks)**
 - The net national welfare effect to the South African economy as a whole. What implicit assumptions do you make in reporting a net result? **(4 marks)**