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① International trade theory

- i. A) X_{ij} is a measurement of the amount of trade between country i and country j .
- b) R_j stands for remoteness. It is a constant which is made up of distance of country j to other countries* and the volume (GDP) of all economies in the whole world (denominator).
- c) GDP_i is the measurement of the size of the economy of country i .
- d) d_{ij} is the geographical distance between the countries i and j .
- ii. The gravity equation which includes remoteness is not naive. It is empirically proven, as it takes other international economies developments into account, as well as sets geographical distance into context.
- iii. If distance doubles between i and j , we expect trade flows to decrease by half.
- iv. If GDP_i rises, R_j will decrease as the distance in the numerator will stay the same, but the size of the world's economies will rise in the denominator.
Assumption: All else remains equal.
- v. In the gravity equation, we assume that all factors are positive. A rise in GDP_i will cause the fraction to increase (numerator becomes larger) and remoteness to decrease (denominator becomes larger). Looking at the composition of R_j we know that

$$\Delta R < \Delta \frac{GDP_i \cdot GDP_j}{d_{ij}^2}$$
Hence trade between i and j (X_{ij}) rises.
The more remote a country is, the more goods it produces inside its economy. As R_j falls, this means j has to import more, hence raising GDP_i leads to more exports from i to j .

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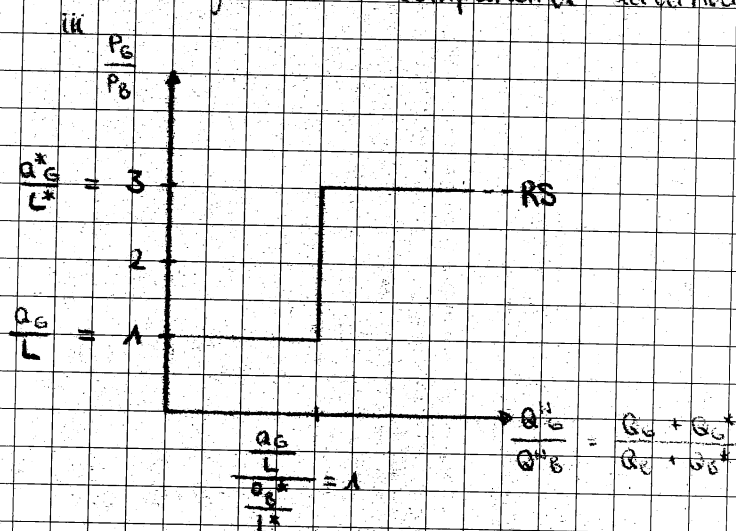
b)

	Q_G	Q_B	L
Home	10	5	10
Foreign	48	16	16

i There is only one factor, which is labour.

ii $\frac{a_{LG}^*}{a_{LB}^*} = \frac{16}{48} = \frac{1}{3} < \frac{a_{LG}}{a_{LB}} = \frac{5}{10} = \frac{1}{2}$

Foreign has a comparative advantage in producing butter.



iv If RD intersects RS at $\frac{P_G}{P_B} = 2$, both countries are fully specialized, home produces only guns and foreign produces only butter. In this case foreign strictly gains from trade, as it can buy guns at a cheaper price than in autarky.

v As a country becomes wealthier, demand for guns relative to butter will increase, shifting the demand curve to the right, if relative prices stay the same.

vi If utility is Leontiff, equilibrium price is 1. This result is unusual, because in this model the countries aren't fully specialized yet. Hence gains from trade are not maximized when utility is maximized. Because in this model there is only one factor, RS takes the form of steps to simplify the specialization analysis. Under Leontiff RD and RS intersect "at the bottom of the first step" implying that trade would not be necessary to get this utility level.

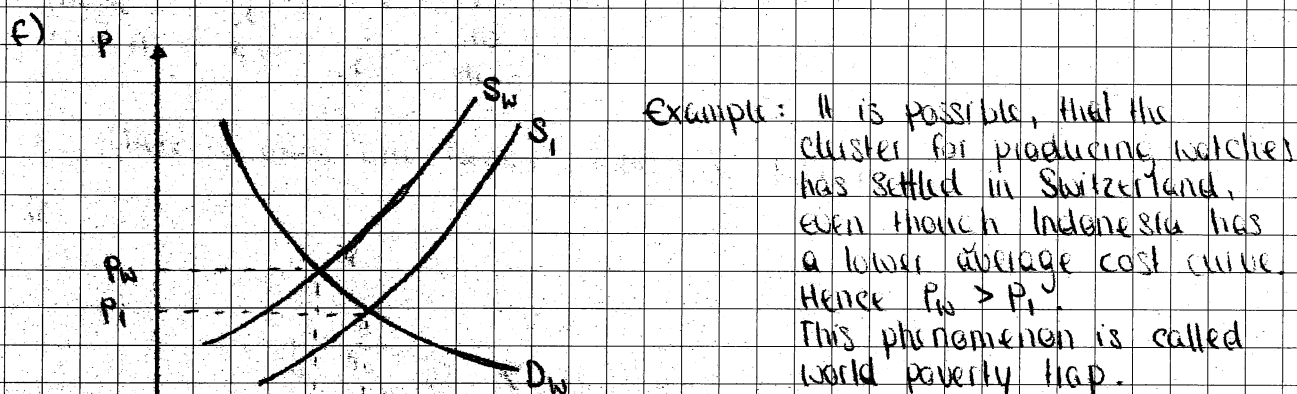
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c) Heckscher Ohlin: A country will export the good which is produced with the factor in which the country has relative abundance.

Factor-price theory: Under trade, prices for the same factor in different locations completely converge.

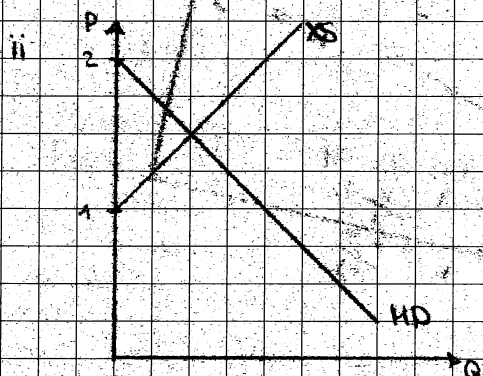
d) In the external increasing returns to scale model, firms are relatively small.

e) Three reasons for external scale economies are knowledge spillovers, specialized suppliers and skilled labour pooling.



② Trade policy

i) AS demand > demand*, home will import and foreign export.



iii) Autarky price home

$$D = S$$

$$4 - P = P$$

$$2 = P$$

Autarky price foreign

$$D^* = S^*$$

$$2 - P = P$$

$$1 = P^*$$

iv) Free trade price

$$P = P^* \cdot \frac{1}{2} = (2 + 1) \cdot \frac{1}{2} = 1.5$$

v) AS HD and XS are equally elastic, home and foreign pay for equal amounts of the tariff.

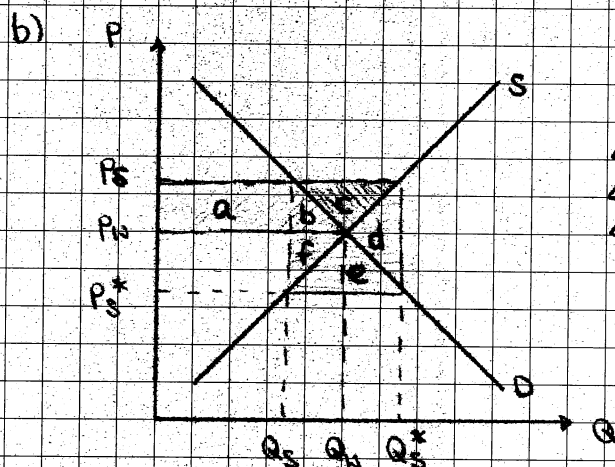
$$0.5 \cdot \frac{1}{2} = 0.25$$

$$\text{Post tariff equilibrium price home: } 1.5 + 0.25 = 1.75 = P_t$$

$$\text{Post tariff equilibrium price foreign: } 1.5 - 0.25 = 1.25 = P_t^*$$

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vi Yes, this analysis is partial equilibrium, as it only takes the two countries into account which are immediately affected, as well as disregards possible substitutes.



$$\begin{aligned}\Delta \text{ consumer surplus} &= -(a+b) \\ \Delta \text{ producer surplus} &= +(a+b+c) \\ \Delta \text{ government expenditure} &= -(b+c+d+e+f)\end{aligned}$$

c) Terms of trade are defined by price of exports, divided by price of imports. An increase in terms of trade here means an improved trade balance.

d) The danish immigration policy is better described by the median voter theory, as those policies do not just concern a small fraction, but the entire population and the future of the country. Political parties hence take the position, which is the most popular among the voters, to get most possible support.

③

a) A revaluation is the increase in value of a ~~fixed~~ currency to a new, lower fixed exchange rate. This change can be implemented by ~~set~~ the central bank and only in fixed exchange rate regimes.

b) The gross national product measures the total production of final goods, which is owned by nationals but can be located anywhere. and services

c) i Yes

i No, the transaction is not included in GNP, as it had been recorded in GNP at the original purchase several years ago.
Assumption: No transaction fees or service charges involved.

ii Yes, as the student has to pay taxes to the national government.

iii Yes, as a hair cut is a final service recorded in GNP.

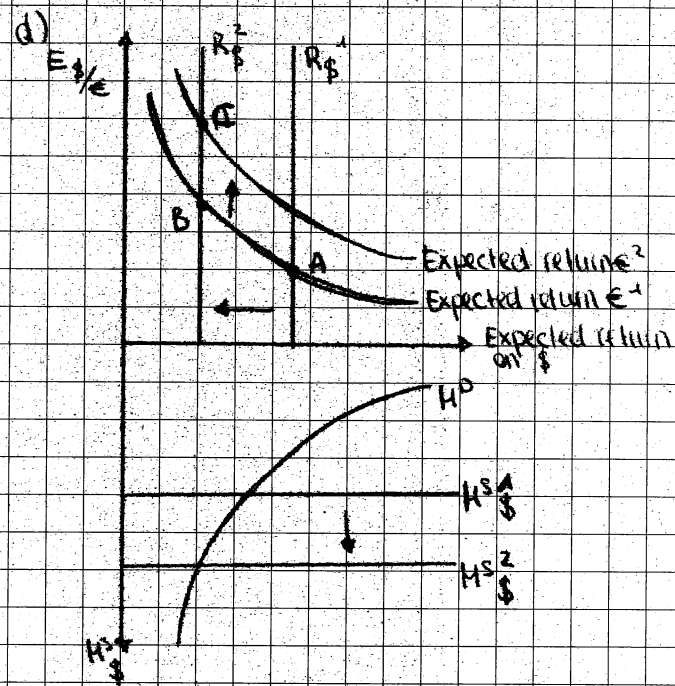
iv No, as no product or service is created in this process, no new wealth is produced.

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»TRYK HÅRDT«
»PRESS HARD«

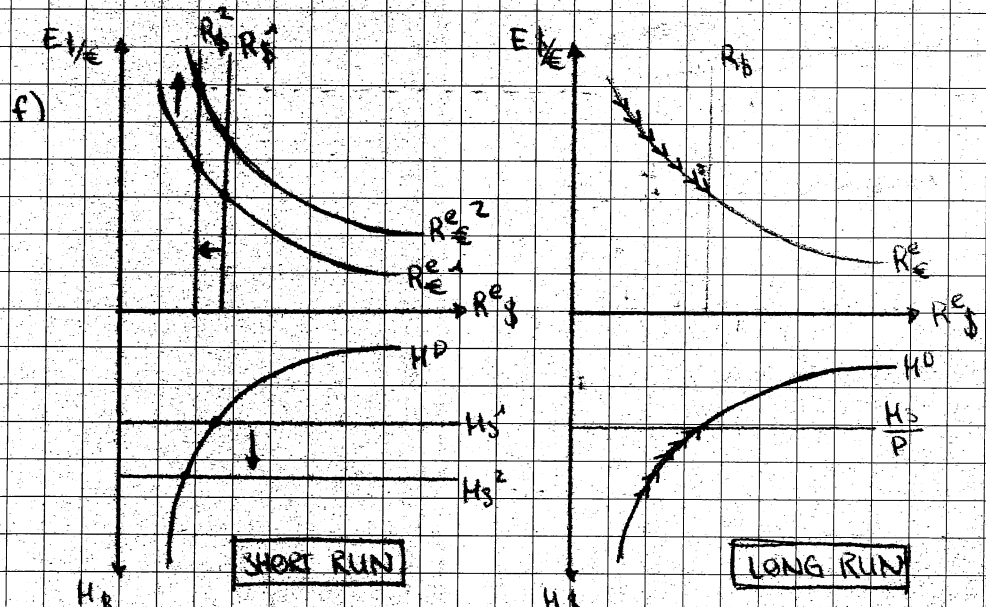


A temporary increase in the money supply of the home currency (\$) shifts the H^S curve down, decreasing the interest rate and increasing national demand for money. The lower interest rate of the dollar means lower expected return on \$ bonds in the international ~~exchange~~ money market, shifting from $R^1_\$$ to $R^2_\$$. This simultaneously boosts the expected return on for example € bonds, shifting that curve upwards. The exchange rate \$/€ hence increase twice, from A to B and from B to C. This consequence of an expansionary monetary policy is known as exchange rate overshooting and cause a large depreciation of the dollar in the short run.

e) According to the purchasing power parity model, purchasing power in two countries should be the same, once you convert one country's currency into the other. This theory can be connected to the interest parity condition which is

$$R_\$ = R_\epsilon \frac{E^{\$/\epsilon} - E^{\$/\epsilon}}{E^{\$/\epsilon}}$$

Further, the model includes inflation and expected inflation, implying that a rise in \$ rate of return will lead to adjustments in expected inflation and hence expected exchange rate (both increase) to make the IPC hold and returns on different currencies equal out.



In the long run exchange rates, rate of return, money supply and demand adjust to real terms.

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④ THE ANTI-SWEATSHOP MOVEMENT IS BAD FOR POOR WORKERS

Anti-sweatshops activists argue, that working conditions violate human rights and high annual rates of suicides speak for themselves. The reason for these bad conditions is in their eyes free trade with developed economies, which they struggle to compete with and are hence stuck in poverty.

But is this really the case? How can they said to be "stuck" when they in fact are a part of globalization and free trade developments?

The Ricardian model shows that through comparative advantage caused by differences in the ~~long~~ technology, all parties (weakly) benefit from trade.

Following the specific factors model, countries specialize based on different factor endowments or according to HO based on their relative abundance.

In countries where sweatshops exist, labour is the relative abundant factor and because it is cheap also the cause of comparative advantage. So what would be the alternative to sweatshops and the exploitation of exactly this advantage?

By exporting the goods which are produced with cheap labour as suggested by HO, the poor countries will get wealthier in the long run, because factor prices will equal out across countries. In the long run, worker will also be able to be retrained, develop new skills and start working in fields with higher wages and working standards.

Hence sweatshops can be seen as a temporary way to grasp market share in international trade. There is currently no better alternative for poor countries, and the less barriers they encounter during their development, the quicker working conditions will improve. Therefore anti-sweatshop movement are actually harmful to poor workers.