

Exam SØK2006 – Spring 2021

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For each of the questions in this exam you should keep in mind always:

- *Models, graphs, and theory are ALWAYS necessary and good. Even better when explicit.*
- *Short and clear answers are encouraged.*
- *Keep your mind open to ideas from every side.*
- *Note: I can only give points to non-blank answers*

1. Suppose country A is rich in high skill labor, and country B is rich in low skill labor. Currently they both live in autarky. (70pt)
 - a) What would be the effect of free trade in these countries in terms of welfare? Assume for simplicity that each resource (high skill/low skill work) can be used to create one different good) To fundament your answer, use model(s) we covered.

Answer: You should choose the Ricardian model, as it is the model that is best suited to answer the question of why countries trade. Using other models will max the answer at 16p. Show how the model finds that trade is always welfare-increasing for the parties. Must answer the question and explain how you get to the answer to get full credit. 20p.

- b) How would free trade impact wealth distribution for country A? Again, use a model learned in class to argue your points.

Answer: Both Specific Factors and H-O models can be used here. After showing what the model finds, by developing it (5p), you must answer the question for country A (high skilled workers get more of the wealth, 10p). 15p.

- c) A shock makes the good intensive in high skill labor scarcer in the global market. What happens with the terms of trade for country A? and for country B?

Answer: Show that ToT improve for A and worsen for B (3p). Use the graph to show that when ToT improve (2p), countries can obtain higher welfare. Show that you understand the mechanism. 5p.

- d) Suppose country A establishes a tariff on imports from country B. Who in country A would benefit from this tariff (low skill workers or high skill workers)? Show the effects of the tariff using what you learned in class

Answer: The tariff will benefit low skilled workers in country A, hurt high skilled. Show using graph how the tariff impacts prices on good intensive in low-skill labor. Show that you understand the mechanism. 15p.

- e) Suppose there are very important economies of scale involved in producing goods that are intensive in low skill labor. Show why a tariff might end up being ineffective in increasing home production in this case.

Answer: Show that a new country would have to establish a tariff larger than the difference in average costs to achieve its goal, a smaller tariff would fail. Use graph to show that the new market competes at a significantly higher average cost because it would start from scratch. Show that you understand the mechanism.15p.

2. A lot of debate was raised by the decision of the US Government (Trump administration) of introducing **retaliatory** tariffs against countries that they perceived behaved unfairly, most notably China. You should use what we have discussed in class, but not limit yourself to it. Remember both China and the US are real countries that will be with us for a long long time. (30pt)

Answer: Make the following points: eliminate or reduce current protectionism from China, eliminate or reduce abuses from China (theft too), collect revenue (US would get a transfer from Chinese producers), get a long-term benefit at a short-term cost, benefit its low-skilled labor.