Econ 142 – Exam 1
Spring 2010
Professor Spearot

NAME: Answer Key
ID:

I have neither given nor received unauthorized aid on this examination, nor have I concealed any similar misconduct by others.

Signature Answer Key

Part 1 (2 points each – circle your answer for multiple choice)

1. Empirically, exporting is
   a. Rare (circled)
   b. Common
   c. Always profitable
   d. At the expense of foreigners
2. Empirically, exporters are more
   a. Skill intensive (circled)
   b. Labor intensive
   c. 'a' and 'b'
   d. None of the above
3. Which group makes up the largest share of exporters?
   a. Firms selling 1 product to 1 export market (circled)
   b. Firms selling 5 or more products to 1 export market
   c. Firms selling 1 product to 5 or more export markets
   d. Firms selling 5 or more products to 5 or more export markets
4. Which group makes up the largest share of export sales?
   a. Firms selling 1 product to 1 export market
   b. Firms selling 5 or more products to 1 export market
   c. Firms selling 1 product to 5 or more export markets
   d. Firms selling 5 or more products to 5 or more export markets (circled)
5. In the Krugman model of trade, the gains from trade come from
   a. Specialization based on endowments
   b. Specialization based on technologies
   c. Lower prices for varieties though increasing returns to scale
   d. Consumption of a wider array of varieties (circled)
6. Who was Ben and Jerry's primary foreign competitor in Japan? Haagen-Dazs
7. Who did Ben and Jerry's choose as its partner in Japan? 7-11

Part 2: (4 points each)

1. What were the positives and negatives of the Canada-US Free Trade agreement for Canada?

Positive: More productive firms
lower prices for consumers

Negative: Job losses

2. What was the effect of containerization on the cost of shipping?

Containerization decreased the cost of shipping.
Estimates between 3 and 13% reduction

3. What is the main difference between "Tramp" shipping and "Liner" shipping?

Tramp: ~~Defined ports~~ - No defined routes / ports of call
- prices set in spot markets

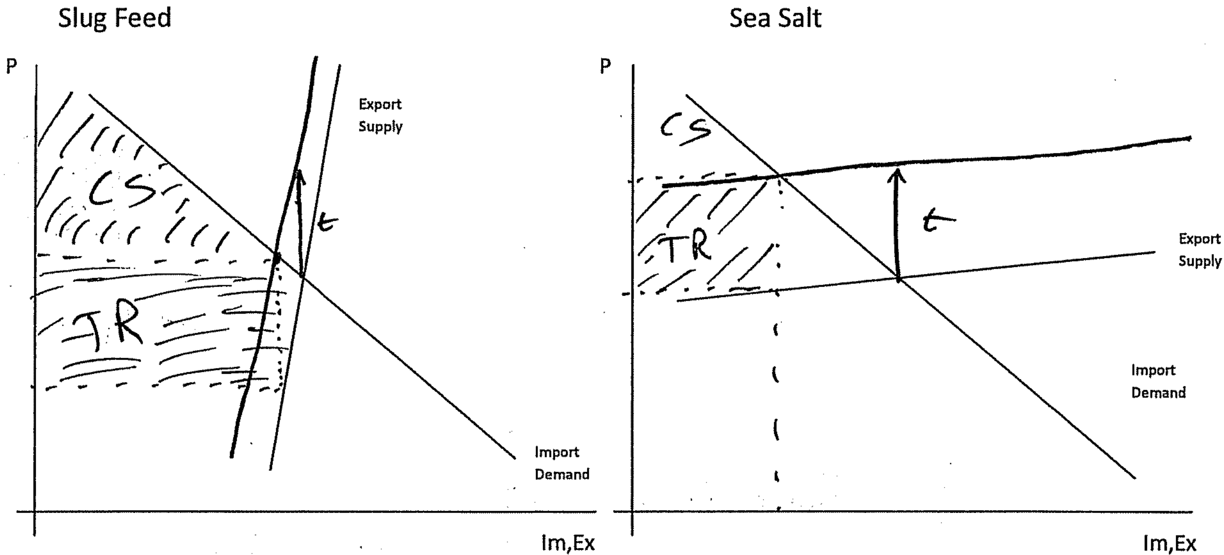
Liner: - Defined routes
- Contract based pricing
- Containerization.

4. List four different costs that can be considered part of the costs of trade:

Distance / transport
Distribution / Marketing
Tariffs / Govt
Insurance

Part 3 – 10 points

1. You are responsible for trade policy in the sovereign republic of Scruziland. For unknown reasons, you are allowed to levy a tariff of level 't' per unit on imports in only one of two industries – slug feed and sea salt. The import demand curves are identical in each industry. The export supply conditions in each industry are illustrated below:



Please identify consumer surplus and tariff revenue after the tariff. In which industry will you impose the tariff? Why? What is the fundamental demand or supply issue at play here?

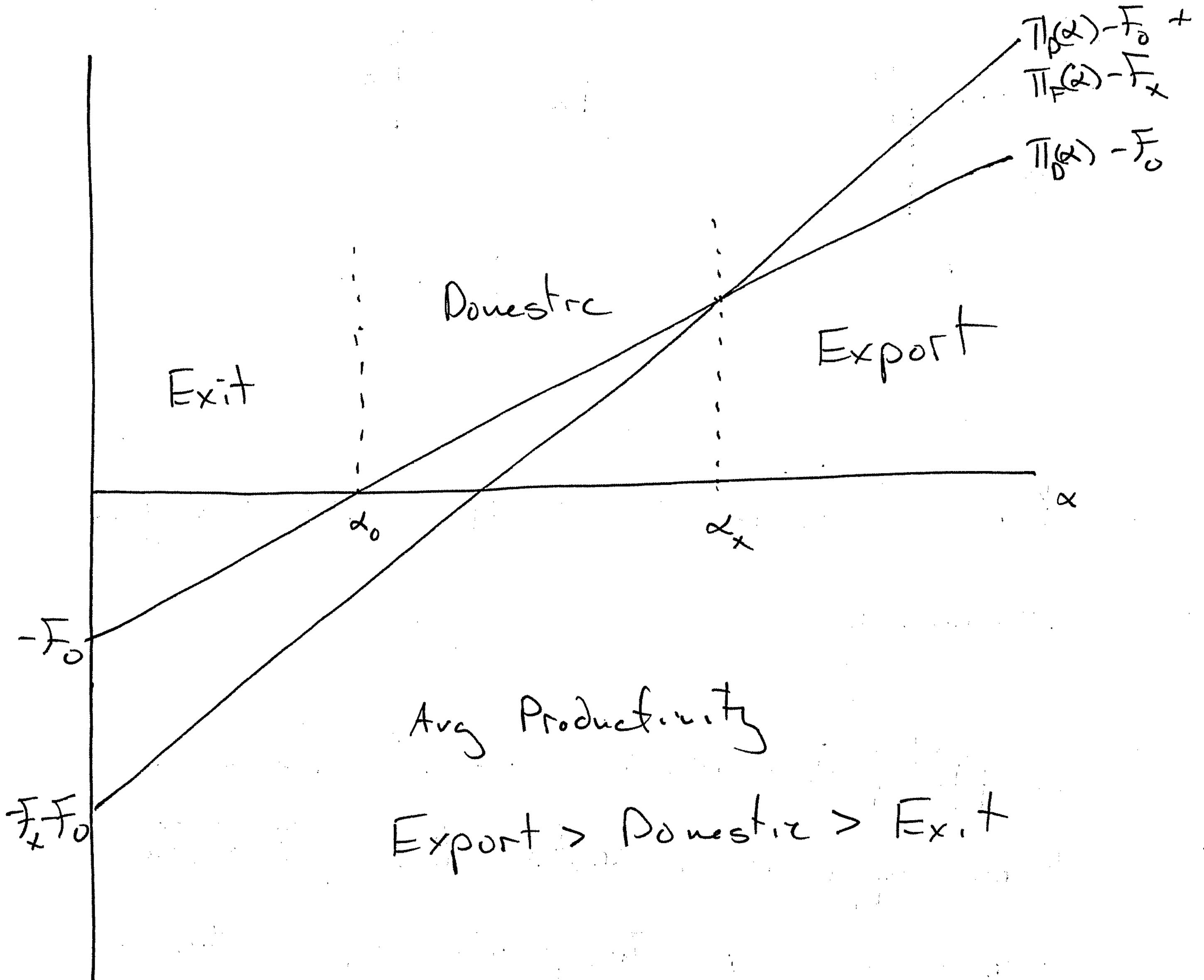
You will impose the tariff on the slug feed industry

Supply elasticities are the issue.
When supply is inelastic, the costs of the tariffs are on the producer. In this case, the producers are foreign, and they do not enter into domestic welfare.

Part 4 – 10 Points each

Consider the "Melitz" exporting model we discussed in class. A firm must decide to exit the market or operate, and if the latter, whether to be purely domestic or an exporting domestic firms. The returns from exiting are zero. If the firm decides to operate in some manner, it must pay F_0 in overhead costs. If the firm also decides to export, it must pay F_X in exporting fixed costs. The firm can earn $\Pi_D(\alpha)$ in the domestic market. If the firm exports, it earns $\Pi_F(\alpha)$ in the foreign market. The term α is firm level productivity, where each profit function is increasing in α.

1. Please graphically detail how firms sort into the three outcomes. Please comment on the relative productivity of each group of firms.



2. Suppose that the foreign market reduces their tariffs. Please detail graphically the effects of this tariff cut. Please also discuss the effect of the tariff cut on the share of active firms and exporting firms, and the average productivity of each group of firms.

Direct effect

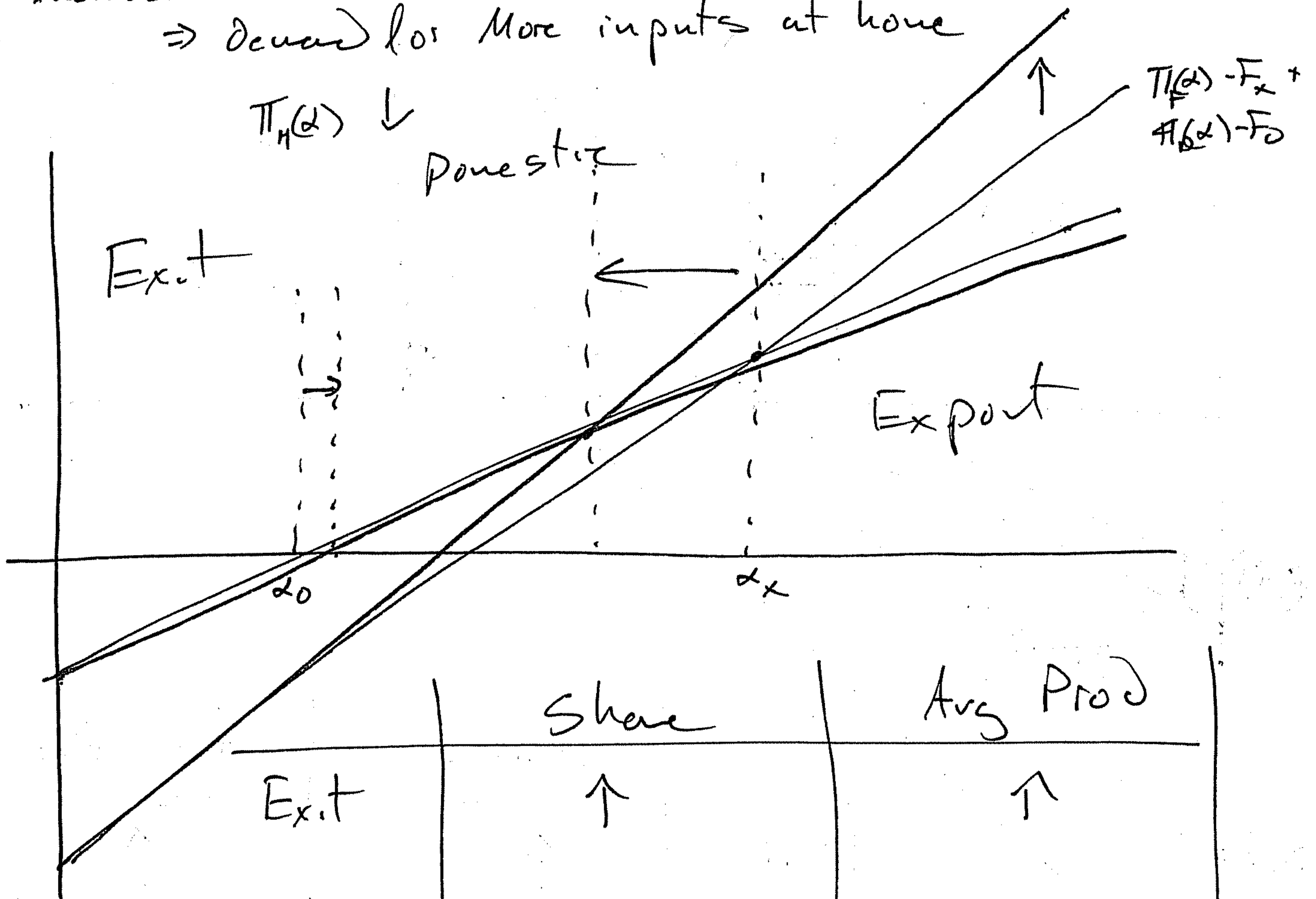
⇒ Easier for Home to Export to foreign

$\Pi_F(\alpha)\uparrow$

Indirect

⇒ Demand for More inputs at home

$\Pi_H(\alpha)\downarrow$



	Share	Avg Prod
Exit	↑	↑
Domestic	↓	?
~~Avg Prod~~ Export	↑	↓

3. Trade financing is quite important, and up to this point, we have not discussed how financing issues play into export decisions at the firm level. Suppose that fixed costs in question 4-1 are specified as:

$$F_0 = (1+r)D$$

$$F_X = (1+r)X$$

Here, 'D' is the capital required for overhead costs, and 'r' is the real rate of interest that must be paid when borrowing 'D'. Further, 'X' is the capital required for exporting, and again, 'r' is the real rate of interest associated with borrowing 'X'. What is the direct effect on the equilibrium in 4-1 when the real interest rate, 'r', rises? Please detail this effect graphically, and comment on the prevalence of active firms and exporting firms, and the average productivity of each group of firms.