Econ 188 – Exam 1
Spring 2011
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 Never Cheats

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

1. High tariffs tend to be levied on imported products
   a. sold at high prices
   b. with high export supply elasticities
   c. from small countries
   d. None of the above
2. Empirically, exporters are more
   a. Capital intensive
   b. Union intensive
   c. 'a' and 'b'
   d. None of the above
3. For Canadian firms, the US Canada Free trade agreement
   a. Increased employment
   b. Increased productivity
   c. 'a' and 'b'
   d. None of the above
4. For the US, the ratio of Exports to Imports ____ over the past 50 years.
   a. rose
   b. fell
   c. stayed constant
   d. fell to zero
5. In the standard model of trade, international trade allows countries to
   a. Use more resources
   b. Consume outside their production possibilities frontier
   c. Consume more varieties
   d. All of the above

Part 2: (5 points each)

1. Ben and Jerry's had three options in deciding if and how to serve the Japanese market. Please list each option, and a pro and con for each.

7-11 Pro Automatic distribution
Con Could be viewed as store brand

+4

Dominos Pro Established American Brand
Con Give up brand rights

Don't Serve Pro Already stretched thin
Con Excess capacity goes unused

+1

2. How did Ben and Jerry's enter the Japanese market? Name three adjustments they had to make for the Japanese consumer.

With 7-11 +2

Change size of serving

Change size of chunks + 1 for each

Make less sweet

Remove "strange" Ben and Jerry

3. Please list two pros and two cons for air shipping.

Pros: Relatively cheap for high value/weight goods
Fast

+2.5

Cons: Infeasible for some products
Expensive per/unit weight

+2.5

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

Marketing

4 total for full marks

Distribution

Insurance

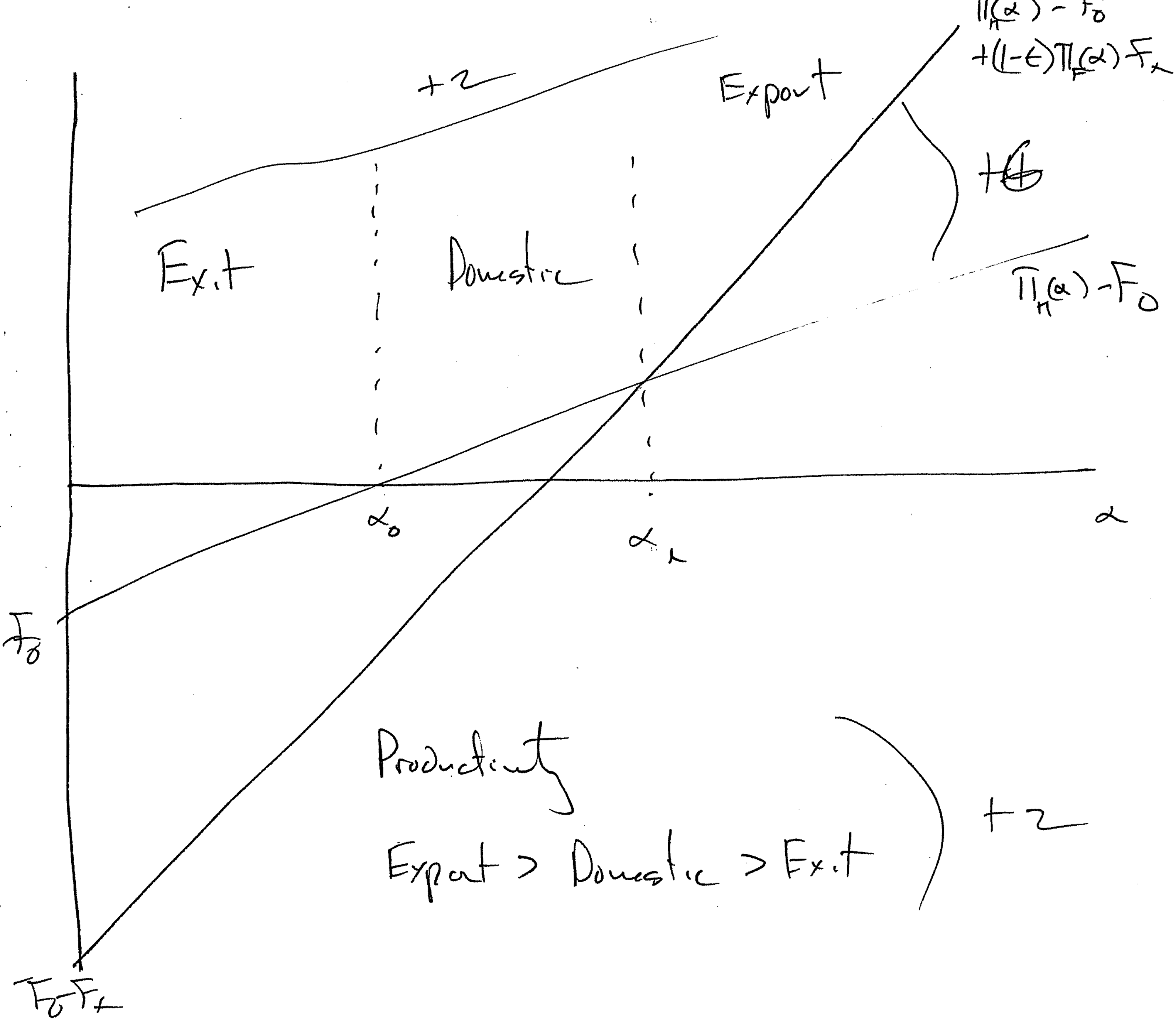
"Red-tape"

A "retainer" for shipping costs

Part 3 – 10 Points each

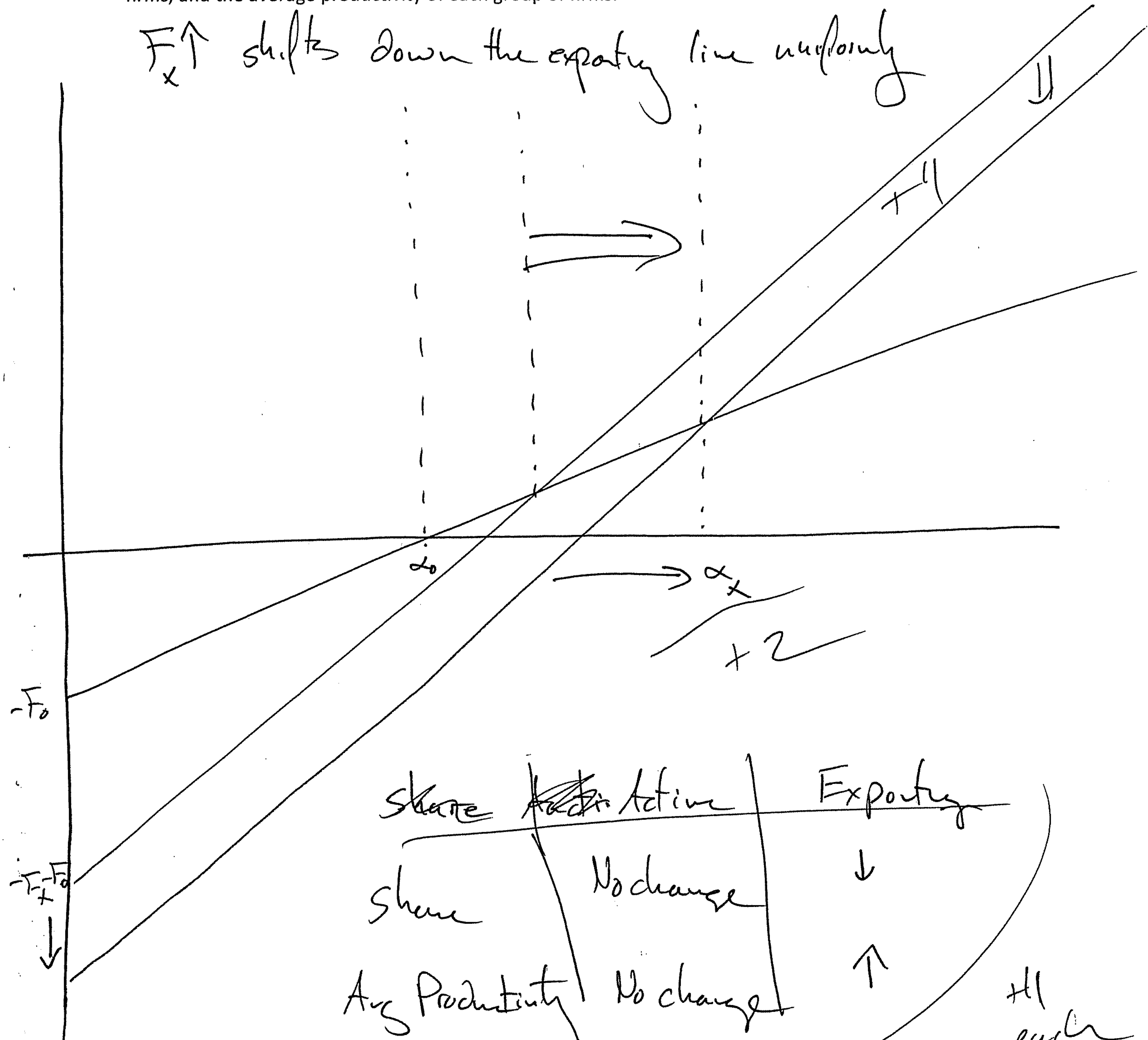
Consider the "Melitz" exporting model we discussed in class. A firm must decide to exit the market or operate, and if the latter, whether to be purely domestic or a domestic firm that also exports. The returns from exiting are zero. If the firm decides to operate in some manner, it must pay F_0 in overhead costs. If the firm also decides to export, it must pay F_X in exporting fixed costs, such as up-front export financing. The firm can earn $\Pi_H(\alpha)$ in the domestic market. If the firm exports, it earns $\Pi_F(\alpha)$ in the foreign market, but loses 't' percent of these profits through a foreign tariff. 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 fixed exporting costs increase. Please detail graphically the *direct* effects of this change. Please also discuss, if any, the effect of the increase in fixed export costs on the share of active firms and exporting firms, and the average productivity of each group of firms.

$F_x \uparrow$ shifts down the exporting line uniformly



~~Share~~	~~Acti~~ Active	Exporting
Share	No change	↓
Avg Productivity	No change	↑

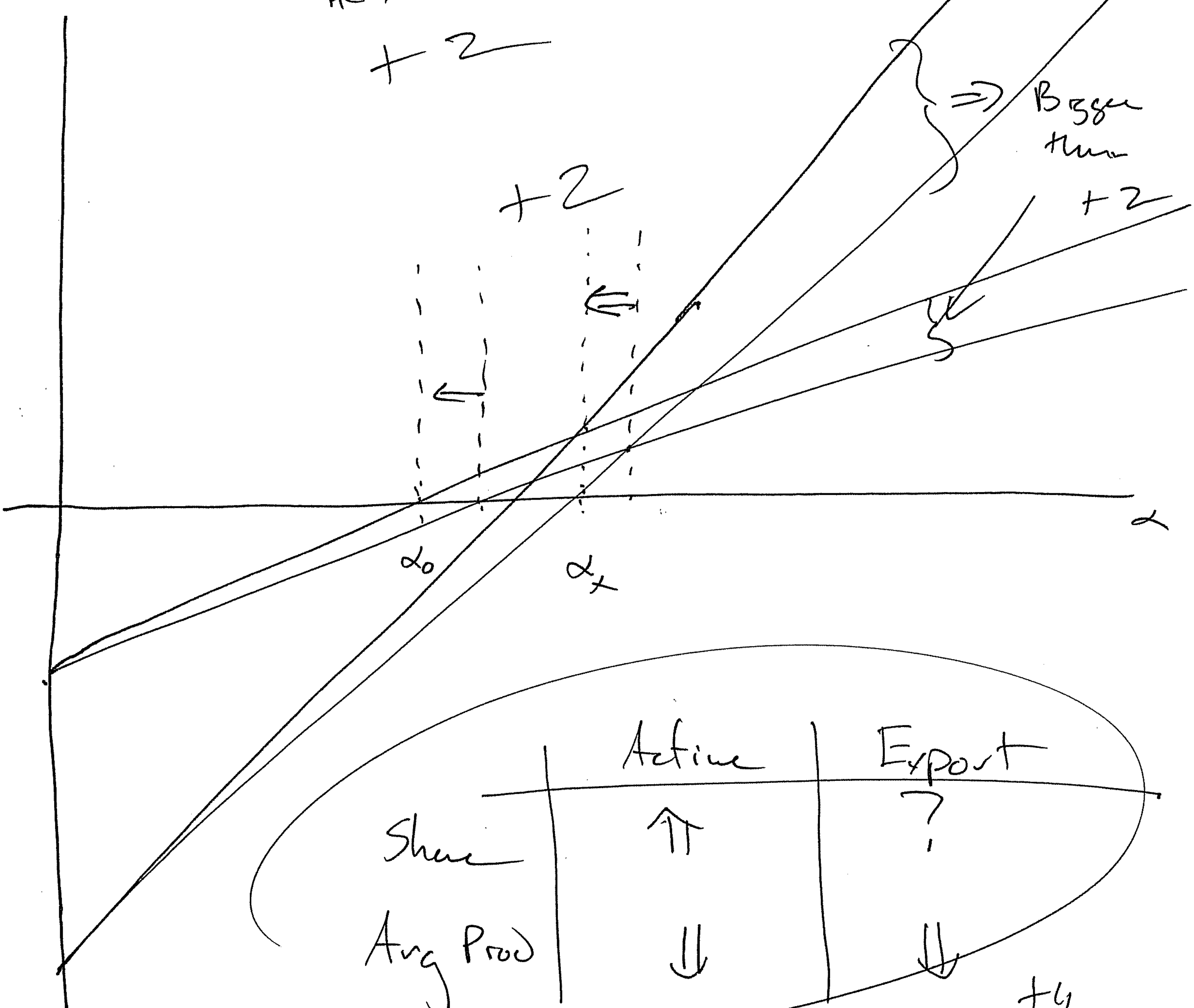
+1 each

3. For the change in costs described in part 2, detail graphically the *indirect* effects of the increase in fixed exporting costs. You may start your analysis from the point after the direct effects. Please discuss, if any, the effect on the share of active firms and exporting firms, and the average productivity of each group of firms.

Fewer exporting firms ⇒ lower labor demand ⇒ lower wages

Indirect $\pi_H(\alpha)\uparrow$ and $\pi_F(\alpha)\uparrow$

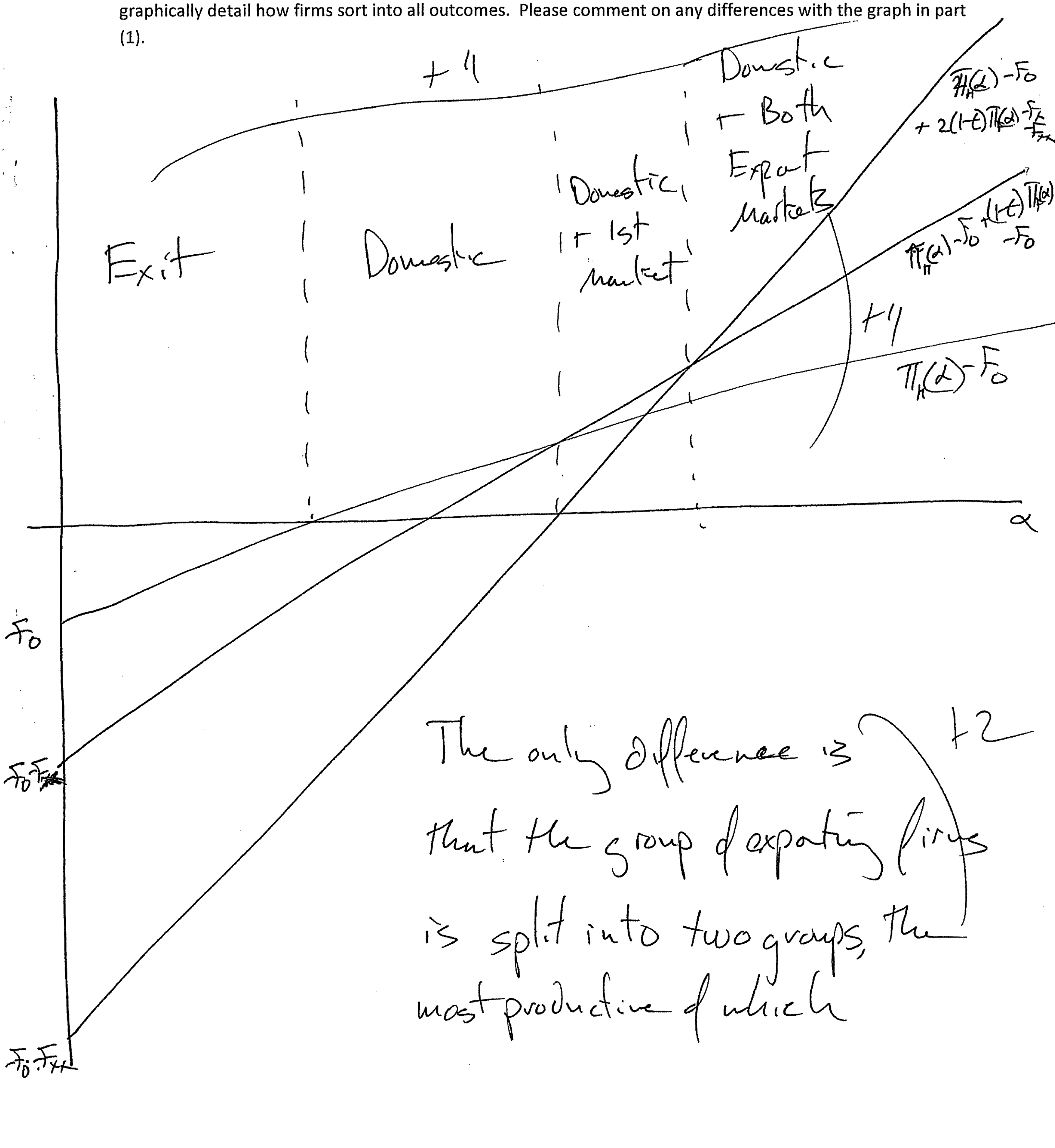
+2



	Active	Export
Share	⇑	?
Avg Prod	⇓	⇓

+4

4. Now suppose that there is an additional foreign market to which firms may export. Similar to the foreign market described in part (1), if the firm exports to this market, it earns $\Pi_F(\alpha)$, but loses 't' percent of these profits through a foreign tariff. However, suppose that the fixed costs in reaching this market, F_{XX}, are larger than the fixed costs to reach the foreign market in the previous questions, F_X. Hence, the firm must not only choose whether to serve a foreign market, but must now decide whether to serve one or both markets. Please graphically detail how firms sort into all outcomes. Please comment on any differences with the graph in part (1).



The only difference is that the group of exporting firms is split into two groups, the most productive of which

+2