Econ 197 – Exam 1 **NAME:_____**
Winter 2013 **ID:_____**
Professor Spearot

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

*Signature*_____

Part 1 (2 points each – circle one unless otherwise noted)

1. An example of a tariff quota is a tariff that is ____
   a. assessed per-unit
   b. assessed as a percentage of value
   c. free up to a specified limit
   d. None of the above
2. Importers are _____ than non-importers (circle all that apply)
   a. More skill intensive
   b. More capital intensive
   c. More union intensive
   d. More input intensive
3. Air shipping is relatively cost effective for _____.
   a. High value goods
   b. High value to weight goods.
   c. 'a' and 'b'
   d. None of the above
4. The Krugman model incorporates gains from trade due to:
   a. Factor endowments
   b. Variety
   c. Productivity differences
   d. None of the above
5. Optimal tariffs are _____ for elastically supplied goods.
   a. higher
   b. lower
   c. the same
   d. zero

Part 2: (5 points each)

1. Please discuss 2 pros and 2 cons of Ben and Jerry's entering the market with Dominos.

PRO

- ***Easy Entry to Japanese Market***
- ***Distribution Established***
- ***Potential investment in brand by Dominos***

CON

- ***Give up brand rights to another party in Japan***
- ***Product is associated with a foreign brand directly***
- ***Forgo wider store sales if successful***

2. Please discuss two ways in which the Canada-US trade agreement had a larger impact on Canadian firms.

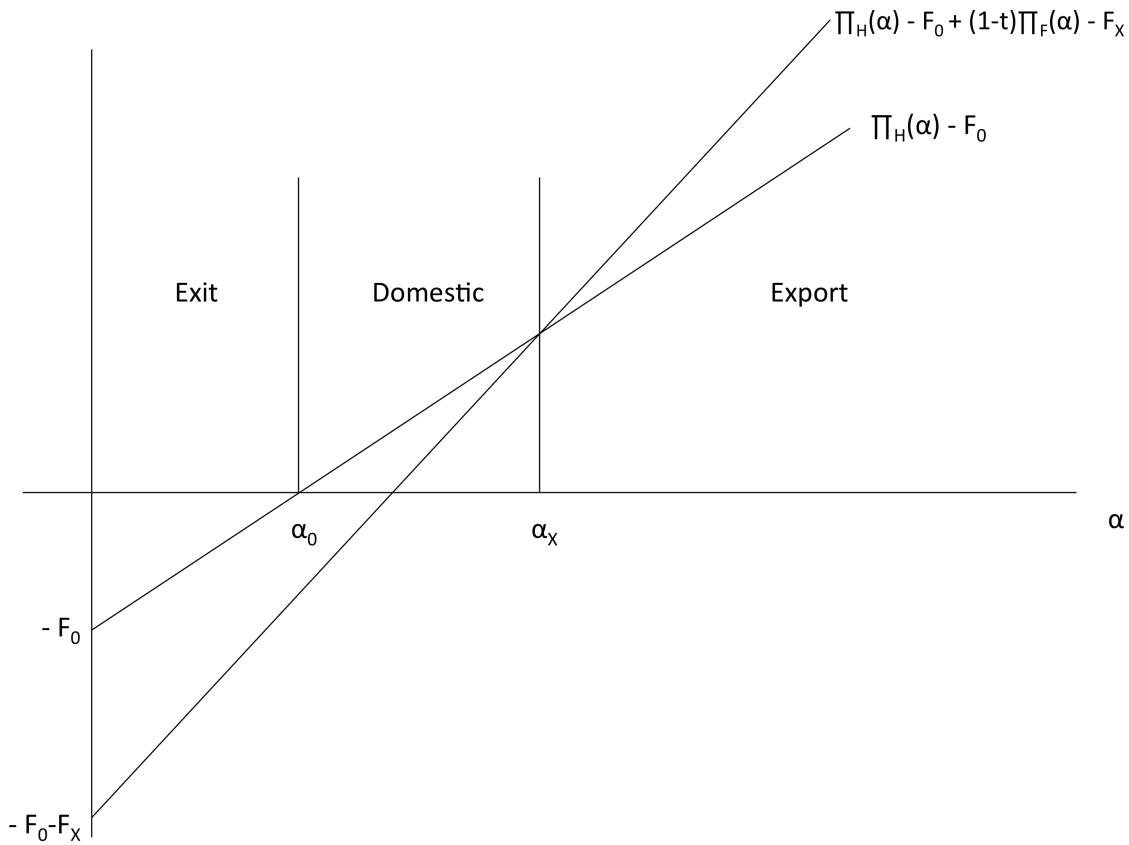
Canada is a small country, and hence stands to gain the most from reducing it's own tariffs

Canada had relatively higher tariffs to begin with

Part 3 – 10 Points each

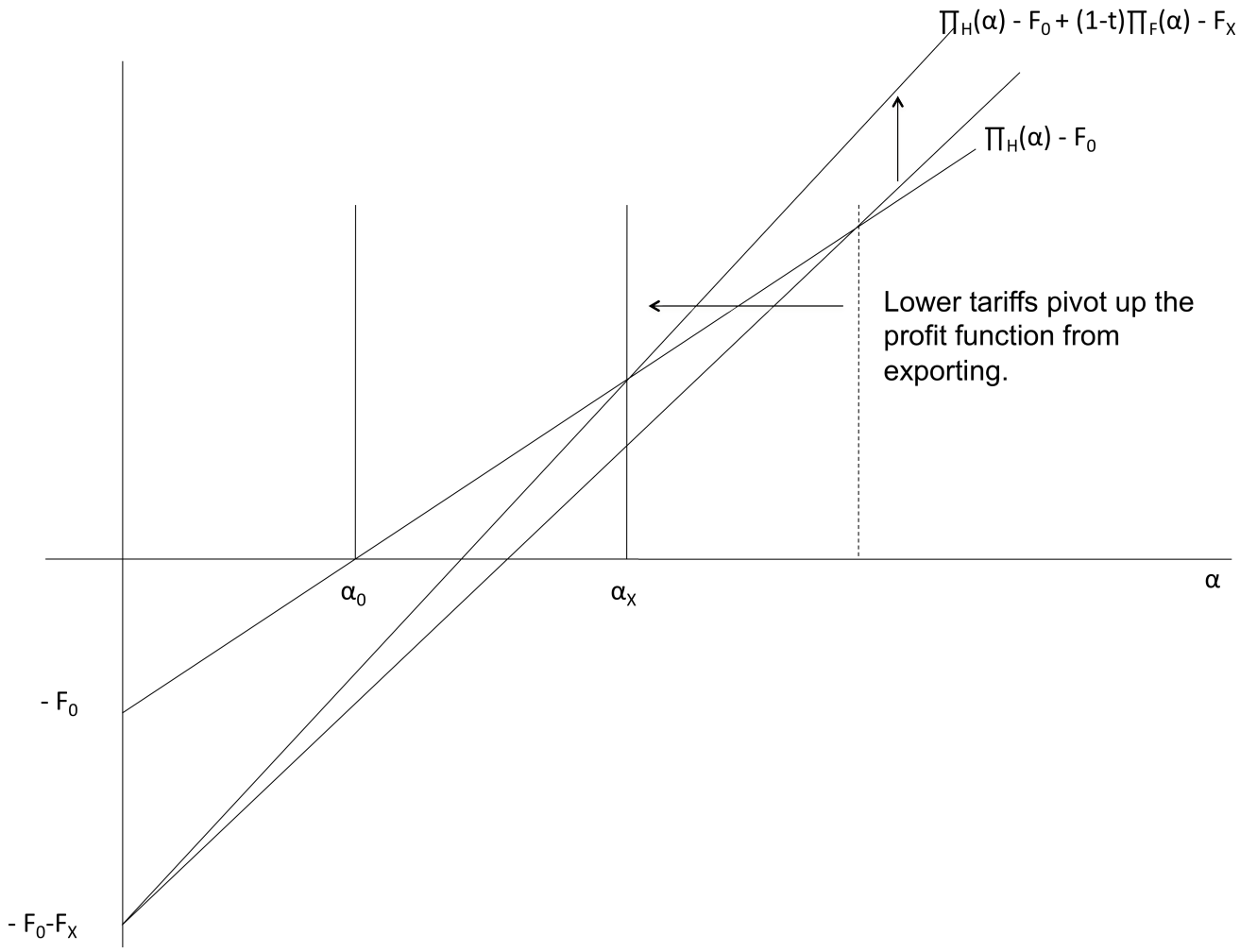
Consider the "Melitz" exporting model we discussed in class. A firm must decide to exit the market or operate, and if the latter, whether to be purely domestic or a domestic firm that also exports. The returns from exiting are zero. If the firm decides to operate in some manner, it must pay F_0 in overhead 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 $\prod_H(\alpha)$ in the domestic market . If the firm exports, it earns $\prod_F(\alpha)$ 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.



Productivity of Exporters > Productivity of Domestic only firms > Productivity of firms that Exit.

2. Suppose that 't' decreases. Please detail graphically the *direct* effects of this change. Please also discuss, if any, the effect of the decrease in 't' on the share of active firms and exporting firms, and the average productivity of each group of firms.



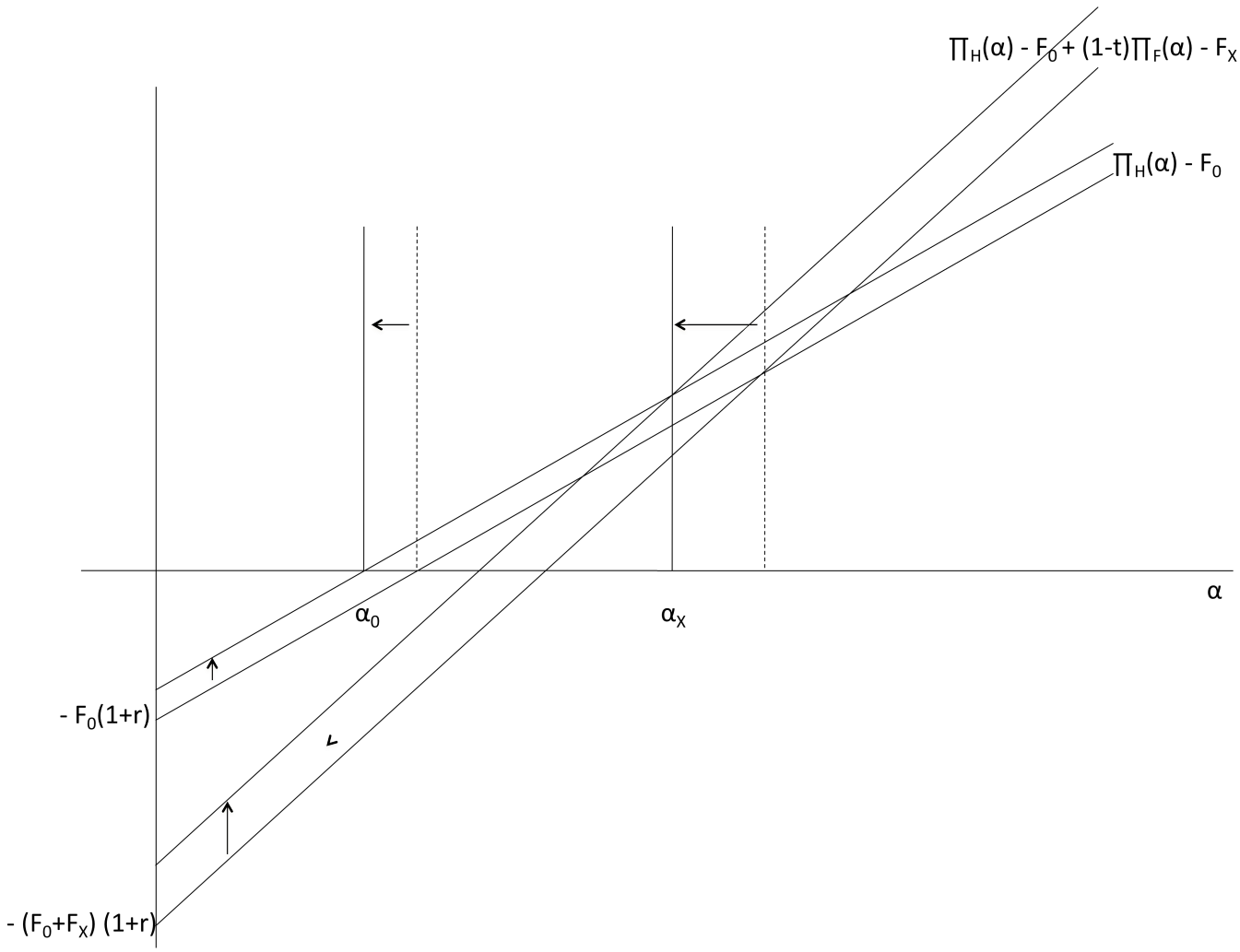
Share of exporter firms rises

Share of active firms stays the same

Productivity of exporting firms rises.

Productivity of active firms stays the same

3. Suppose that firms must pay interest on fixed costs, where overhead costs are now $F_0(1+r)$, and fixed exporting costs are $F_X(1+r)$, where r is the interest rate on borrowing. Further, suppose that due to quantitative easing in response to a crisis, r falls. Assuming that all three outcomes occur before and after, please detail graphically the *direct* effects of this change, and discuss (if any) the effect of the decrease in 'r' on the share of active firms and exporting firms, and the average productivity of each group of firms.



Both curves shift up, but the exporting firm curve shifts up by more than the domestic curve since the interest rate affects both overhead and exporting fixed costs. Both cutoffs shift down.

Share of active firms goes up.

Share of exporting firms goes up.

Productivity of active firms goes down

Productivity of exporting firms goes down