

The University of Illinois at Chicago

Economics 514: International Trade and Policy

Midterm Examination Review

Answer true or false and explain your answer. These questions are worth 5 points each.

1. If you have traveled to poor developing countries, you will have noticed that people there consume very different goods than U.S. consumers. This means that tastes in developing countries are very different from U.S. tastes.
2. The U.S. should not restrict textile imports in order to save American jobs.
3. The total quantity of labor rises in your country, and the available quantity of capital decreases. This will not affect either the shape or the position of the production possibility curve.
4. Changes in commodity prices affect the distribution of income among consumers.
5. Canada should adopt policies to stop exporting primary products, because countries that export primary products do not get gains from trade. Gains from trade go to the countries exporting manufactured products.
6. An increase in the labor supply of a small country could decrease the volume of trade.

These questions are each worth 20 points.

7. Your country, on an island in the Pacific, has long produced both coconuts (good X) and all other goods (good Y) with tools and labor (2 factors). Both "goods" are consumed, and indifference curves are the usual shape.
 - a. Draw your autarky situation.
 - b. The world discovers your paradise, and, since prices in the outside world differ from prices on your island country, trade will result. The price of coconuts is higher in the outside world than in your country. Draw the new situation after trade. What happens to production of coconuts? What happens to the quantity of coconuts consumed in your country?
 - c. True or false and explain: If production cannot change from the autarky levels in either industry, trade must result in a drop in consumption of coconuts.
 - d. True or false and explain: If production can respond to the new world price, the quantity of coconuts consumed at home could rise.
 - e. True or false and explain: Reduction in coconut consumption increases welfare, compared with taking advantage of trade to consume more of both

goods.

8. Suppose there is only one technology that can be used in clothing production. To produce a unit of clothing requires 4 labor-hours and 1 unit of capital. All other goods require 1 labor-hour and 1 unit of capital. At an initial equilibrium, suppose the wage rate and the capital rental rates are each valued at \$2.
 - a. If both clothing and all other goods are produced, what are their prices?
 - b. Keep the price of all other goods constant, and raise the price of clothing to \$15. What are the effects on the distribution of income?
 - c. How do your results in (b) relate to the Stolper-Samuelson theorem?
 - d. Find the full-employment level of output for each good if capital stock is 500 units and labor hours available are 1000 units. (Use the Lerner-Pearce diagram.)
 - e. Find the lowest (e) and highest (f) capital stocks that still allow full employment of both factors.
 - f. See above.
 - g. Draw the transformation schedule for each of the cases in (e) and (f).