

Section III: International Economics- Questions**Chapter 3.1: International Trade****Question 1**

Suppose a simple world economy with two countries, Oceanland and Grassland, each of which produces two goods, seafood and dairy products. Oceanland has an absolute advantage in the production of both seafood and dairy products, while Grassland has a comparative advantage in the production of dairy products.

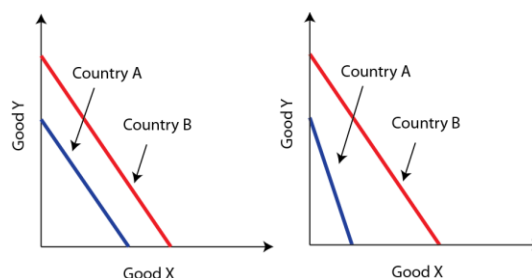
- Draw a diagram showing the absolute and comparative advantages of each country.
- State which products each country should export and import, according to the theory of comparative advantage.
- Show points of possible production and consumption for each of the two countries, after specialization and trade according to comparative advantage.
- Outline two possible sources of comparative advantage.

The following data show the quantity of output that can be produced by country X and country Y if all their resources are used to produce either good A or good B.

Production Possibilities of Country A & Country B		
	Good A (Units per day)	Good B (Units per day)
Country X	40	20
Country Y	50	100

- Calculate the opportunity cost of good A and good B in country X, and the opportunity cost of good A and good B in country Y.
- State which country has a comparative advantage in good A, which in good B, and which has an absolute advantage in both goods.
- Using the data in the table, draw a diagram illustrating the comparative advantage of each country.

The following questions are based on the diagrams below, illustrating production possibilities curves.



- In diagram (i), can either country benefit from specialization and trade? Outline why or why not.
- In diagram (ii), state which country has the comparative advantage in which good, and which country has the absolute advantage in both goods.

Question 2

Riverland had a tariff of 5 Rvl per kg of seafood. Domestic production of seafood with the tariff was 70 000 kg per week, domestic consumption was 150 000 kg per week, and the price was 25 Rvl per kg. Because of World Trade Organization (WTO) rules, the government of Riverland was forced to eliminate the seafood tariff. As a result, domestic production fell to 50 000 kg per week and consumption increased to 180 000 kg per week.

- a. Calculate the quantity of seafood imports in Riverland with the tariff and the quantity of imports after the tariff was eliminated.
- b. Calculate the price of seafood paid by consumers and the price received by producers in Riverland after the tariff was removed.
- c. Draw a diagram showing the price of seafood, domestic quantity produced, domestic quantity consumed, and the quantity of imports (i) with the tariff, and (ii) after removal of the tariff. (The diagram does not have to be drawn to scale.)
- d. Calculate the change in consumer expenditure on seafood in Riverland due to the removal of the tariff.
- e. Calculate the change in domestic producer revenue from seafood in Riverland due to the removal of the tariff.
- f. Calculate the change in the government budget in Riverland due to the removal of the tariff.
- g. Calculate the change in foreign producers' export revenue from seafood exports to Riverland.
- h. State two stakeholders who gained from the removal of the tariff.
- i. State two stakeholders who lost from the removal of the tariff.
- j. Given the information above about Riverland, explain who has a comparative or absolute advantage in seafood production, Riverland or its trading partners.
- k. Using your diagram from part (c), show the amount of welfare that was gained by Riverland when the tariff was eliminated (i.e. welfare loss that was regained).