

Question 3

Flatland had an import quota of 150 000 kg of dairy products per week, because it wanted to protect its dairy industry. As a result of the quota, domestic producers were selling 350 000 kg of dairy products per week, at a price of 20 Ftl (the domestic currency) per kg. Due to complaints by its World Trade Organization (WTO) trading partners, Flatland was forced to eliminate the dairy quota. The elimination of the quota caused the price of dairy products to fall to 15 Ftl per kg, domestic production dropped to 250 000 kg per week, and imports increased to 400 000 kg per week.

- a. Calculate the quantity of domestic consumption of dairy products before the removal of the quota and after the removal of the quota.
- b. Calculate the amount by which imports increased following the removal of the quota.
- c. Draw a diagram showing the price of dairy products, domestic quantity produced, domestic quantity consumed, and the quantity of imports (i) with the quota, and (ii) after removal of the quota. (The diagram does not have to be drawn to scale.)
- d. Calculate the change in consumer expenditure on dairy products in Flatland due to the removal of the quota.
- e. Calculate the change in domestic producer revenue from dairy products in Flatland due to the removal of the quota.
- f. Calculate the change in foreign producers' export revenue from dairy exports to Flatland.
- g. Calculate the amount of quota revenue that was generated when the quota was in place.
- h. Assuming that the quota revenues were given to foreign producers, calculate the total effect on foreign producers from the removal of the quota, taking into account both export revenues and quota revenues.
- i. State two stakeholders who gained from the removal of the quota.
- j. State one stakeholder who lost from the removal of the quota.
- k. State one important difference between imposing a tariff and imposing an import quota.
- l. Using your diagram from part (c), show the amount of welfare that was gained by Flatland when the quota was eliminated (i.e. welfare loss that was regained).
- m. State two economic benefits for the Flatlander or global economy (other than impacts on stakeholders) that might arise from the removal of the import quota.

Question 4

Grassland used to grant a subsidy on cereals of 5 Gsl (the local currency) per kg. Due to the subsidy, domestic production was 150 000 kg per week, and imports amounted to 75 000 kg per week. The price paid by consumers was 25 Gsl per kg. A number of Grassland's trading partners complained that Grassland was dumping its cereals in the international market, and threatened to impose anti-dumping tariffs. Grassland therefore removed its subsidy on cereals. Following the removal of the subsidy, domestic cereal production fell to 80 000 kg per week.

- a. Calculate/state the price received by producers when they were receiving the subsidy and after the removal of the subsidy.
- b. Calculate the total amount of cereals consumed per week in Grassland before the removal of the subsidy and after the removal of the subsidy.
- c. Calculate the quantity of imports per week after the removal of the subsidy.

- d. Draw a diagram showing the price of cereals, domestic quantity produced, domestic quantity consumed, and the quantity of imports (i) with the subsidy, and (ii) after removal of the subsidy. (The diagram does not have to be drawn to scale.)
- e. State/calculate the change in consumer expenditure on cereals arising from the removal of the subsidy.
- f. Calculate the change in producer revenue from sales of cereals due to the removal of the subsidy.
- g. Calculate the change in the government's budget due to the removal of the subsidy.
- h. Calculate the change in foreign producers' export revenue from cereal exports to Grassland.
- i. State two stakeholders who gained from the removal of the subsidy.
- j. State one stakeholder who lost from the removal of the subsidy.
- k. State one stakeholder who was unaffected by the removal of the subsidy.
- l. Outline two arguments that could be used to justify the use of subsidies as a trade protection measure.

Chapter 3.2: Exchange Rates & the Balance of Payments

Question 1

Suppose a traveller from Riverland, whose currency is the Rvl, would like to visit Mountainland, whose currency is the Mnl. The two currencies initially exchange at the rate of 1 Mnl = 2.5 Rvl.

- a. Find the value of 1 Rvl in terms of Mnl.
- b. The traveler from Riverland would like to bring 1500 Rvl with her to Mountainland converted into Mnl. How many Mnl will she receive when she exchanges 1500 Rvl?
- c. While in Mountainland, the traveller from Riverland runs out of Mnl but wants to buy some presents for her friends that cost 175 Mnl. Given the exchange rate above, how many Rvl must she exchange in order to make these purchases in Mnl?
- d. While exchanging Rvl for Mnl, the traveler discovers that the exchange rate has changed, and now stands at 1 Mnl = 2.7 Rvl. How many Rvl must she exchange to get 175 Mnl at the new exchange rate?
- e. Distinguish between currency appreciation and depreciation, and state which currency appreciated and which depreciated.
- f. Calculate the percentage appreciation of the appreciating currency and the percentage depreciation of the depreciating currency.
- g. Identify three factors that may have led to the exchange rate change between the Mnl and the Rvl.
- h. Draw a diagram illustrating how one of the factors you identified above caused a change in the value of the appreciating currency.