



AFRICAN ECONOMIC RESEARCH CONSORTIUM

Collaborative MA Programme in Economics for Anglophone Africa
(Except Nigeria and South Africa)

JOINT FACILITY FOR ELECTIVES
JULY - OCTOBER 2002

INTERNATIONAL ECONOMICS

First Session: Final Examination

Time: 9.00 am - 12 noon

Tuesday August 13, 2002

INSTRUCTIONS:

1. Answer any FIVE of the following six questions.
2. They are of equal weight.
3. Explore formal models or diagrams as appropriate to support your discussion.

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1. Consider an economy that has two factors of production (labour and capital) and produces two goods (coffee and milk). This economy is labour-abundant and capital-scarce. The production of coffee is labour-intensive and milk is capital-intensive. In the short run, labour is the only mobile factor between the sectors. In the long run, both capital and labour are mobile between the sectors. As a result of free trade, the price of coffee has increased on the world market. Consider both parts of the question.

- (i) Explain the fact that in this economy labour experiences ambiguous change in its reward in the short run and unambiguous change in the long run. (6 points)
- (ii) Explain that capital in one sector must experience a short run change in its reward that is opposite to its long run change. (6 points)

2. Attempt both parts of the question.

- (i) Demonstrate that with factor intensity reversal the Factor Price Equalisation (FPE) theorem must be rejected (formal proof of the FPE theorem is not required). (6 points)



- (ii) Explain the phenomenon of immiserizing growth in a large country. (6 points)
3. "In a two-country world, a tariff may make one country better off, but must be sub-optimal for the world as a whole". Discuss this statement. (12 points)
4. A small developing East African country is considering increasing domestic production of an import-competing good (sugar). You are asked to advise the government of this country on whether to choose a tariff or a production subsidy as a means of achieving the domestic production target. State your recommendation and the case for it. (12 points)
5. Consider a duopoly market structure of a home firm and a foreign firm who behave in Cournot manner and are competing for sales in a third country. Assume that they do not sell any output in their domestic markets.
- (i) Explain how an export subsidy to the home firm by the home country government will affect the sales of the home firm and its country's welfare. (6 points)
- (ii) Now assume that the firms compete for sales in each other's domestic markets. Explain how the imposition of a tariff by the home country government will affect the sales of the home firm and the welfare of this country. (6 points)
6. Discuss all the following:
- (i) Trade Policy reform and government revenue; (4 points)
- (ii) Export-oriented industrialisation; (4 points)
- (iii) Import substitution industrialisation. (4 points)