**International Trade 31E00500: Winter 2019**

PROBLEM SET 1

*Due on 17.1.2019 at 23.55. Please submit your homework electronically via MyCourses. Solutions of the questions are going to be discussed in exercise session on 18.1.2019.*

1. Around 30 years ago, two communist countries, Russia and China, started their transition to build market-oriented economies. Initially, their political and economic systems have been rather similar with very low competitiveness in production of manufactured goods. At present, China has transformed into the largest exporter of manufacturing goods in the world and Russia – into one of the largest exporter of oil and gas in the world. Let’s analyze why this has happened in a simple Ricardian framework. Suppose Russia and China produce only two goods, oil and computers. The following table shows costs of production of one barrel of oil and one computer (in US dollars) in Russia and China. Assume that 10 000 US dollars are available in both countries for investment in production.

|  |  |  |
| --- | --- | --- |
|  | Russia | China |
| Oil | 30 | 100 |
| Computer | 400 | 100 |

1. Explain which country has comparative (or even absolute) advantage in which product.
2. What are the autarky prices of computers and oil in Russia and China?
3. Indicate exactly what range of prices for computers/oil should be offered on international markets for both countries to be profitable from international trade. What will Russia and China import and export?
4. Let`s assume that there are two countries in the World, “Developed” and “Emerging”, and they have identical consumer preferences and technologies. “Emerging” is labor abundant country and “Developed” is capital abundant country. Let`s assume that only two products are produced – shoes (labor intensive production) and computers (capital intensive production). Let’s analyze two countries` trade integration with the Heckscher-Ohlin model.
5. Draw a consistent graph in which you indicate the autarky production and consumption points of “Developed” and “Emerging” countries with the help of production possibility frontiers and utility curves.
6. Explain intuitively whether the relative price of shoes in Developed country is higher or lower compared with the relative price of shoes in Emerging country when both countries are in autarky. How can you illustrate it on graph? In production of which product, each country has a comparative advantage in the autarky.
7. Using Heckscher-Ohlin model, show what will happened when countries start to trade.
8. In 90s, Russia was a large importer of American wheat and Russian Trade Policy Commission planned to impose 16% import tariff on American wheat, price of which was 125 US dollars per ton. Though the Commission decided not to impose the tariff, according to experts` calculations, this would lead to significant decrease of Russian demand for American wheat. As a result world price of American wheat would decrease by 4% and Russian import of wheat would decrease to 10 million tons.
9. Show on the graph the amount of possible revenues for Russian budget if the tariff would be imposed;
10. Draw a partial equilibrium figure of the Russian wheat market if the tariff would be imposed. Indicate clearly the volume of American wheat imports before and after the imposition of the tariff.