

Homework Questions for Chapter 8

(1) Suppose a country, Home, wants to encourage the development of high-resolution wide screen televisions. These are currently quite expensive, priced at \$6,500 per television. The components used in making such televisions cost \$3,000. Similar Foreign televisions can be imported at the world market price of \$5,000.

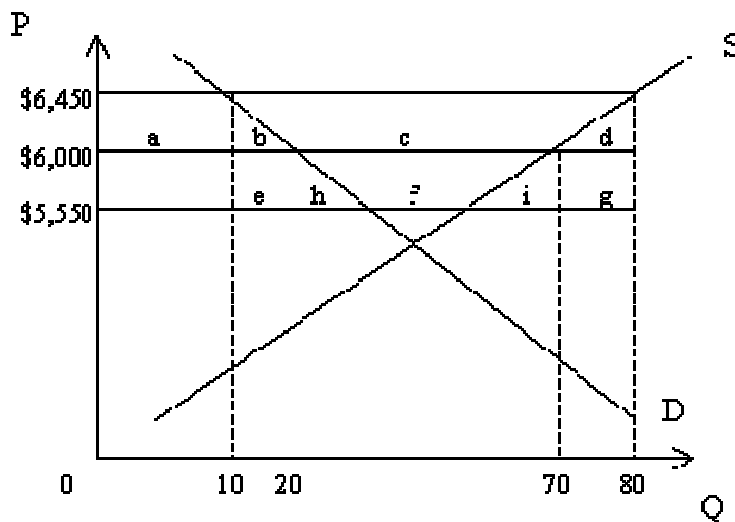
a. Using an infant industry argument, which claims that domestic manufacturers should be protected from foreign competition in certain young industries, would you recommend an ad valorem tariff? How large should it be?

b. At this level of tariff, what is the effective rate of protection on assembly of domestic high-resolution televisions?

c. Who are the winners and who are the losers from this protection?

(2) Compare the welfare effects of a voluntary export restraint and a tariff on a large economy. Which trade policy is more costly? Why is this policy used in practice?

(3) Suppose that Home exports 50 tractors a year at the world price of \$6,000. The Home government, seeking to expand the domestic tractor industry and its exports, places a \$900 specific export subsidy on tractors. This results in an increase in the Home price of tractors to \$6,450 and a lowering of the Foreign market price to \$5,550. The figure below depicts the exporting country's tractor market.



a. Why doesn't the new price for tractors at home fully reflect the export subsidy?

b. How are Home production and exports affected by the export subsidy?

c. What is the impact of the export subsidy on consumer surplus? Producer surplus? Government revenues?

d. In terms of the graph above, which areas depict consumer surplus, producer surplus, and government revenues?

e. What is the effect of the export subsidy on Home's terms of trade?