

# **Tutorial Letter 201/2/2017**

**International Trade**

**ECS3702**

**Semester 2**

**Department of Economics**

**IMPORTANT INFORMATION**

This tutorial letter contains solutions to Assignment 01.

## CONTENTS

1. Introduction.....	3
2. Answers to Assignment 01 .....	3
3. The examination .....	7
4. Prescribed material for the examination .....	7
5. Assessment.....	7
6. Copy of the October 2016 examination paper .....	7
7. Communication with lecturers.....	13
8. Concluding remarks.....	13

Dear Student

## 1. INTRODUCTION

To date, you should have received the following study material for ECS3702:

- M001 document
- Tutorial Letter 101/2017 (introductory tutorial letter and assignments)
- Tutorial Letter 301/2017 (general information to all Economics students)

This tutorial letter contains the following information:

- answers to Assignment 01

Read this tutorial letter carefully together with Tutorial Letter 101 and the other study material that you have received. In this way, you will find answers to many of your questions.

## 2. ANSWERS TO ASSIGNMENT 01

Make sure that you **understand** where and why you have made mistakes in your assignment. Refer to the relevant pages in the MO001 document or the prescribed textbook (TB). We provide an explanation if the answer is not self-evident from the prescribed material.

You had to answer 20 multiple-choice questions for this assignment, PLUS 10 student-profile questions. The questions appeared on pages 31 to 35 of Tutorial Letter 101.

### ANSWERS TO THE QUESTIONS OF ASSIGNMENT 01

[1]	1	[6]	3	[11]	1	[16]	2
[2]	4	[7]	4	[12]	1	[17]	0
[3]	4	[8]	4	[13]	4	[18]	3
[4]	2	[9]	4	[14]	2	[19]	3
[5]	2	[10]	1	[15]	1	[20]	1

**QUESTION 1**

**The correct alternative is 1.**

By trading, a nation is able to consume a mix of goods and quantities that are beyond what they could produce domestically.

**QUESTION 2**

**The correct alternative is 4.**

Mercantilists argued that for a nation to gain from trade the other nation had to lose; hence, they viewed trade as a zero sum game. The classical and other subsequent trade theories viewed trade as mutually beneficial. Thus for countries to trade voluntarily, they had to benefit.

**QUESTION 3**

**The correct alternative is 4.**

**QUESTION 4**

**The correct alternative is 2.**

Absolute advantage refers to the greater efficiency that one nation has over another in the production of a commodity.

**QUESTION 5**

**The correct alternative is 2.**

The theory of comparative advantage is based on the idea that although one trading partner might have complete and absolute advantage over its trading partner in the production of all commodities, room still exists for mutually beneficial trade to take place if both nations traded in the good in which they had a comparative advantage. That is, the nation with no absolute advantage will specialise in the production of the product of its smallest absolute disadvantage.

**QUESTION 6**

**The correct alternative is 4.**

According to the theory of absolute advantage, for trade to take place, each nation must have an absolute advantage in at least one of the goods. If a nation does not have an absolute advantage, then it would not be able to trade. Alternatively, if one nation had an absolute advantage in the production of both goods, then there would be no need to trade.

**QUESTION 7**

**The correct alternative is 4.**

Zambia is the more efficient producer of copper since it produces more copper in the same time, using the same resources than South Africa, while South Africa is the more efficient producer of gold.

**QUESTION 8**

**The correct alternative is 3.**

The opportunity cost of producing one unit of copper in South Africa is 10 units gold, while in Zambia it is 0.33 units gold. Therefore, given that the opportunity cost of producing gold is lower in Zambia than in South Africa, Zambia has a comparative advantage in producing copper.

On the other hand, the opportunity cost of producing gold in South Africa is 0.1 units copper, while the opportunity cost of producing gold in Zambia is 3 units copper. Therefore, since the opportunity cost of producing gold is lower in South Africa than in Zambia, South Africa has a comparative advantage in producing gold.

**QUESTION 9**

**The correct alternative is 4.**

The assumption of the classical theories was that there were no transport costs, thus they did not factor in the influence of transport costs in trade.

**QUESTION 10**

**The correct alternative is 1.**

See page 59 of the textbook.

**QUESTION 11**

**The correct alternative is 1.**

See section 3.4 of the textbook.

**QUESTION 12**

**The correct alternative is 1.**

See section 3.2c, page 57, of the textbook.

**QUESTION 13**

**The correct alternative is 4.**

The FPT posits that comparative advantage, and thus trade, arises due to differences in factor endowments between nations.

**QUESTION 14**

**The correct alternative is 2.**

As a nation increases its production of its product of comparative advantage, it uses its abundant and cheap factors of production. Thus, the demand for this factor of production will increase and therefore the income for the factor will increase. For example, as a labour-abundant country specialises in its production of labour-intensive goods, the demand for labour will increase and therefore, the wages/ salaries earned by labour will increase. In this same way, since it now produces less/fewer of the good that requires its scarce and expensive factor of production, the demand for this factor of production decreases and so does its remuneration.

**QUESTION 15****The correct alternative is 1.**

As a nation increases its production of its product of comparative advantage, it uses its abundant and cheap factors of production. Thus, the demand for this factor of production will increase and therefore the income for the factor will increase. For example, as a labour-abundant country specialises in its production of labour-intensive goods, the demand for labour will increase and therefore, the wages/ salaries earned by labour will increase. In this same way, since it now produces less/fewer of the good that requires its scarce and expensive factor of production, the demand for this factor of production decreases and so does its remuneration.

**QUESTION 16****The correct alternative is 2.****QUESTION 17****The correct alternative is 0.****QUESTION 18****The correct alternative is 3.**

According to the specific factors model, trade will have an ambiguous effect on the nation's mobile factors, benefit the immobile factors specific to the nation's export commodities or sectors and harm the immobile factors specific to the nation's import-competing commodities or sectors.

**QUESTION 19****The correct alternative is 3.****QUESTION 20****The correct alternative is 1.**

Read section 6.5A in the prescribed textbook for the explanation of the technological gap model and the product cycle model.

### 3. THE EXAMINATION

The examination paper consists of two sections. All the questions in section A are compulsory and students must answer two questions of their choice from section B. Each question counts 25 marks. All competencies will be tested. Questions will range from multiple-choice questions to short and long essays. **Writing in point form (bullets) or using asterisks (\*) is unacceptable, except when listing assumptions. You will be penalised for failing to adhere to this instruction.**

Ensure that you prepare well for the final examination by concentrating on the prescribed material as outlined in your study guide and Tutorial Letter 101.

### 4. PRESCRIBED MATERIAL FOR THE EXAMINATION

You will be examined on any of the prescribed chapters outlined in Tutorial Letter 101 and the study guide. Therefore, ensure that you are familiar with the module content, including the relevant diagrams.

### 5. ASSESSMENT

As indicated in Tutorial Letter 101, your semester (year) mark will be based on your assignment marks. The first assignment will contribute 25%, the second assignment will contribute 25% and the third assignment will contribute 50% to your semester mark. Your final mark will be calculated using the following weights:

Semester (year) mark:	20%
Final examination mark:	80%
Total:	100%

### 6. COPY OF THE MAY 2016 EXAMINATION PAPER

Answer question 1 and question 2 from **section A** and **any two (2)** questions of your choice from **section B**. **Each question carries 25 marks.**

Beantwoord vraag 1 en vraag 2 in **afdeling A** en **enige twee (2)** vrae van u keuse uit **afdeling B**. **Elke vraag tel 25 punte.**

#### SECTION A

#### AFDELING A

**All students must answer questions 1 and 2 in section A.**

**Al die studente moet vrae 1 en 2 in afdeling A beantwoord.**

## QUESTION 1

### VRAAG 1

- (a) Briefly define/explain the following terms:  
Definieer/verduidelik kortliks die volgende terme:

- (i) autarky (3)  
outarkie of selfonderhoudendheid (3)

*The absence of trade or isolation.*

- (ii) capital intensity and capital abundance (4)  
kapitaalintensiteit en kapitaaloorvoedigheid (4)

**Capital intensity** refers to the relative ratio of labour and capital that goes into the production of a good. A good is said to be capital intensive if the capital labour ratio is higher compared to the other good.

**Capital abundance** refers to the relative endowment of factors of production in a country. A nation is said to be capital abundant if the total capital/total labour ratio in the country is higher compared to the other country/trading partner.

- (iii) a tariff and a quota (3)  
'n tarief en 'n kwota (3)

*An import tariff is a tax or duty on imports. It is imposed on goods as they cross international boundaries. Examples are specific tariffs and ad valorem tariffs. A quota is a direct quantitative restriction on trade or on quantities imported.*

- (iv) strategic trade policy (5)  
strategiese handelsbeleid (5)

*The argument that an activist trade policy in oligopolistic markets subject to extensive external economies can increase a nation's welfare. The government of that nation needs to protect some large oligopolistic industries. This is done to increase their market share at the expense of foreign competitors. To increase the global share of domestic firms, strategic trade policy requires large capital, but as output increases, marginal costs fall. There is a lack of information to help government make its decision. There is also a loss of production efficiency.*

**Answer question 1(b) by circling the correct option. Each answer is worth two (2) marks.**

**Beantwoord vraag 1(b) deur die korrekte antwoord te omkring. Elke antwoord is twee (2) punte werd.**

- (b) Which of the following is correct regarding the predictions of the H-O theory with regards to a country participating in international trade?

Watter van die volgende is korrek wat betref die voorspellings van die H-O-teorie met betref 'n land wat aan internasionale handel deelneem?

When a nation begins to trade with other nations,

- (i) demand for the nation's abundant factor of production will \_\_\_\_\_.  
**increase**                                      decrease                                      remain unchanged
- (ii) the price of the abundant factor of production will \_\_\_\_\_.  
**increase**                                      decrease                                      remain unchanged
- (iii) the price of the nation's scarce factor will \_\_\_\_\_.  
 increase                                      **decrease**                                      remain unchanged
- (iv) the production of the country's export good will \_\_\_\_\_.  
**increase**                                      decrease                                      remain unchanged
- (v) the production of the country's import-competing good will \_\_\_\_\_.  
 increase                                      **decrease**                                      remain unchanged

(10)

Wanneer 'n nasie begin om met ander nasies handel te dryf,

- (i) sal die vraag na die nasie se oorvloedige produksiefaktor \_\_\_\_\_.  
 toeneem                                      afneem                                      onveranderd bly
- (ii) sal die prys van die oorvloedige produksiefaktor \_\_\_\_\_.  
 toeneem                                      afneem                                      onveranderd bly
- (iii) sal die prys van die nasie se skaars faktor \_\_\_\_\_.  
 toeneem                                      afneem                                      onveranderd bly
- (iv) sal die produksie van die land se uitvoeritem \_\_\_\_\_.  
 toeneem                                      afneem                                      onveranderd bly
- (v) sal die produksie van die land se invoer-mededingende item \_\_\_\_\_.  
 toeneem                                      afneem                                      onveranderd bly

(10)

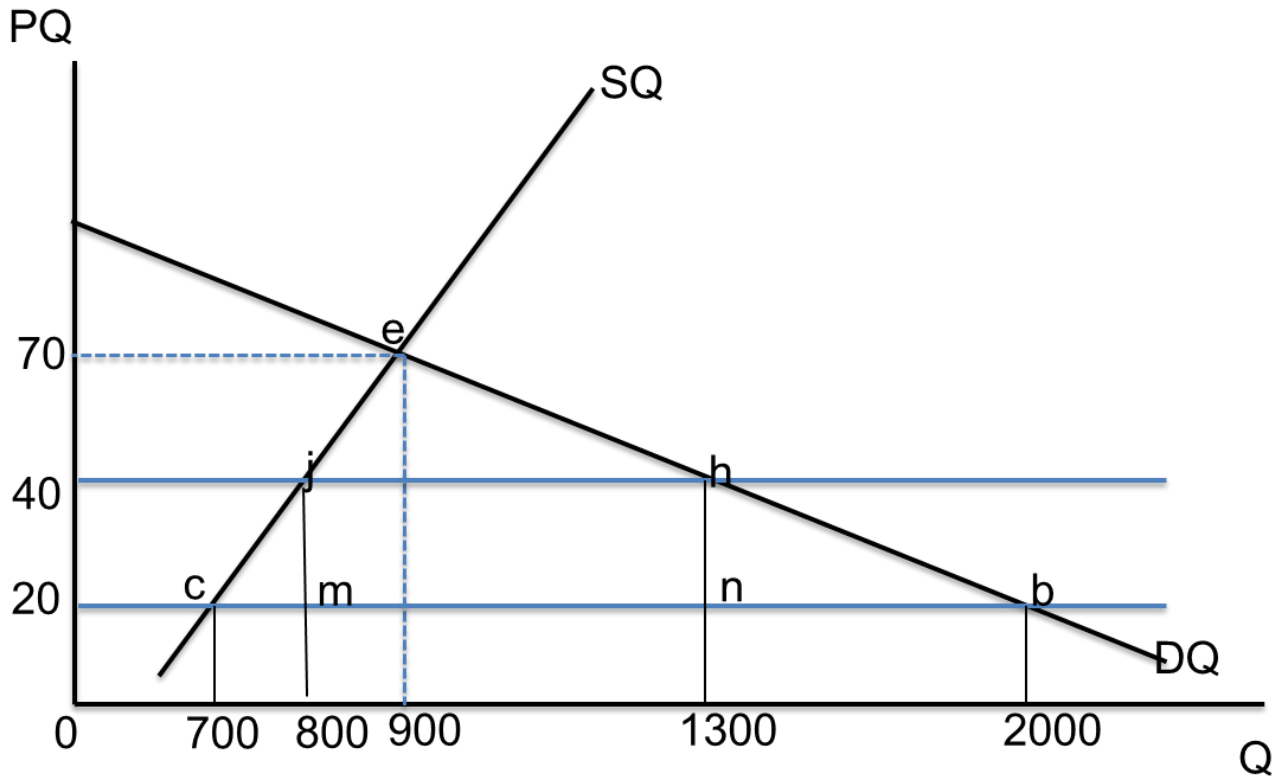
[25]

## QUESTION 2

### VRAAG 2

Use the figure below of the partial equilibrium effect of a quota to answer question 2.

Gebruik die onderstaande figuur van die gedeeltelike-ewewigseffek van 'n kwota om vraag 2 te beantwoord.



(a) How much is the quota restriction on commodity Q? (2)  
 Hoeveel is die kwotabeperking op kommoditeit Q? (2)

(b) What is the effect on the domestic price of commodity Q of the imposition of the quota amount you stated in (a) above? (2)

Wat is die effek op die plaaslike prys van kommoditeit Q as gevolg van die daarstel van die kwotabedrag wat u in (a) aangedui het? (2)

(c) How much is the quota rents in the above figure? (2)  
 Hoeveel is die kwotarente in die bostaande figuur? (2)

(d) Explain the consumption and production effects of the imposition of the import quota as given in the figure above. (5)

Verduidelik die verbruiks- en produksiegevolge van die daarstel van die invoerkwota soos gegee in die bostaande figuur. (5)

(e) Assume that the quota of the amount you have determined in (a) above is presently in place and there is now an increase in the demand for commodity Q in the diagram provided.

Veronderstel dat die kwota van die bedrag soos wat u in (a) hier bo bepaal het, tans in plek is en dat daar nou 'n toename in die vraag na kommoditeit Q in die gegewe diagram is.

- (i) Illustrate the changes you expect to see. (6)  
 Illustreer die veranderings wat u verwag om te sien. (6)
- (ii) Explain the corresponding effects as a result of the increase in demand for commodity Q. (8)  
 Verduidelik die ooreenstemmende gevolge vanweë die toename in die vraag na kommoditeit Q. (8)

[25]

## SECTION B AFDELING B

Students must answer any **TWO (2)** of the following three questions in this section.

Die studente moet enige **TWEE (2)** van die volgende drie vrae in hierdie afdeling beantwoord.

### QUESTION 1 VRAAG 1

Assume there are two countries, Kuvukiland and Wonderland; there are two inputs, labour and capital; and two goods, computers and clothes. Assume also that the consumers are capital intensive and Kuvukiland is capital abundant. Using the Heckscher-Ohlin theorem, explain the pattern of and gains from trade when trade takes place between Kuvukiland and Wonderland.

(NB: You must use correctly drawn and appropriate diagram(s) to aid your answer.) [25]

Veronderstel daar is twee lande, Kuvukiland en Wonderland; daar is twee insette, arbeid en kapitaal; en twee goedere, rekenaars en klere. Neem ook aan dat die verbruikers kapitaalintensief is en dat Kuvukiland kapitaaloorvloedig is. Deur gebruik te maak van die Heckscher-Ohlin-teorie, verduidelik die handelspatrone en -wins wanneer handel tussen Kuvukiland en Wonderland plaasvind.

(NS: U moet gebruik maak van korrek getekende en toepaslike diagram(me) om u antwoord te staaf.) [25]

### QUESTION 2

#### VRAAG 2

Evaluate the following statement:

“Tariffs have a more negative effect on welfare in large countries than in small countries”. [25]

Evalueer die volgende stelling:

“Tariewe het ’n negatiewer uitwerking op welvaart in groot lande as in klein lande”. [25]

### **QUESTION 3**

#### **VRAAG 3**

Assume that South Africa is a capital abundant nation and the rate of return is much lower (5%) compared to Nigeria where the rate of return on capital is higher (25%). Using a well-drawn diagram, illustrate and explain the effects of international capital transfer between the two nations. **[25]**

Veronderstel dat Suid-Afrika 'n kapitaaloervloedige land is en dat die opbrengskoers heelwat laer is (5%) in vergelyking met Nigerië, waar die opbrengskoers op kapitaal hoër is (25%). Deur gebruik te maak van 'n goed getekende diagram, illustreer en verduidelik die gevolge van internasionale kapitaalvloei tussen die twee lande. **[25]**

**Note that the solution to question 1 has been provided. You should work through the rest as you prepare for the examination and if you need guidance, contact us.**

**Let op dat die antwoord op vraag 1 gegee is. U moet deur die res van die vrae werk wanneer u vir die eksamen voorberei en as u hulp nodig het, kontak ons.**

## 7. COMMUNICATION WITH LECTURERS

The lecturers for this module are as follows:

- Dr K Amusa – 012 433 4642
- Dr J Mkhize – 012 433 4623

Appointments with the above lecturers should be made in advance. If you arrive without an appointment, the lecturers might not be able to see you immediately.

While we are happy to help you if you do not understand some of the economic principles, we do expect final-year students to try to solve problems themselves.

Do not contact your lecturers regarding administrative queries. Contact the relevant department (as listed in the brochure *Study @ Unisa*).

**Please note:** The telephone lines at Unisa are very busy during examination time (May and October). There is no guarantee that you will be able to get through to your lecturers in the last days before the examination. Therefore, go through your work **in good time** and **if** you have problems, contact us well before the examination.

## 8. CONCLUDING REMARKS

We hope that you have enjoyed studying this module. We wish you well as you prepare for the examination.

Kind regards

**Dr K Amusa**