

Tutorial Letter 203/1/2018

International Trade ECS3702

Semester 1

Department of Economics

IMPORTANT INFORMATION

This tutorial letter contains solutions to Assignment 03.

BAR CODE

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Dear Student

1. INTRODUCTION

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

- Study guide
- Tutorial Letter 101/2018 (introductory tutorial letter and assignments)
- Tutorial Letter 301/2018 (general information to all Economics students)
- Tutorial Letter 201/2018 (solutions to Assignment 01)
- Tutorial Letter 202/2018 (solutions to Assignment 02)

This tutorial letter contains the following information:

- answers to Assignment 03

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. FEEDBACK ON ASSIGNMENT 03

Please note: The following are **NOT** model answers. They are a guide only on how you could answer the questions. Also, note that your study guide is aimed at guiding you through the prescribed book and that you are expected to study the relevant sections in the prescribed book as well as the study units in the study guide. In other words, you must buy the prescribed book. The relevant sections in the prescribed book are clearly indicated in each study unit of the study guide.

Read the questions carefully and make sure that you do what is asked. When you answer the questions, keep the topic of the questions clearly in mind. Do not go off on a tangent, filling many pages, as it will not earn you marks. Therefore, make sure that each of your answers does in fact reflect what you have been asked to do.

QUESTION 1

What is the AGOA agreement? In what ways has the agreement impacted the South African economy? Your answer should include a comprehensive discussion of the positive and negative impacts that may have been experienced by the South African economy. **(25 marks)**

This question required students to do research and to provide a general understanding of AGOA. Students should have provided a detailed enough discussion, with credible and well-referenced sources.

QUESTION 2

The South African economy is considered to be an open economy, with significant external trade (international trade). According to an article in *Business Day* published on 22 March 2017, “South Africa’s current account deficit narrowed to 1.7% of GDP during the fourth quarter of 2016, from 3.8%, exceeding expectations as exports outpaced import growth” (Asha Speckman, *Business Day*, 22 March 2017).

- (a) Does the above statement follow (concur) or go against (refute) the ideology of the mercantilists? Explain your response, basing your discussion on the mercantilist ideology. (15 marks)

The above statement shows that the current-account deficit decreased because of an increase in South Africa’s exports. This corresponds in part with the view of the mercantilists who advocated for a surplus of exports over imports. Mercantilism was developed by writers in Europe between 1500 and 1800. According to this policy, trade is a zero sum game, where the gains of the winners are offset by the losses of the losers. Since not all nations could have trade surpluses at the same time, it means that one nation gains at the expense of the other. Trade is based on self-interest. Mercantilists believed that in order to become rich and powerful, a nation must export more than it imported, thus accumulating precious metal or bullions. Therefore, governments had to ensure that exports were stimulated and imports restricted using tariffs and other trade barriers. The excess of exports over imports led to an inflow of precious metals such as gold and silver or bullion.

- (b) What criticism(s) did David Hume and Adam Smith level against the mercantilists’ view of trade? (10 marks)
- (i) Hume showed that a favourable trade balance is a temporary phenomenon. In the long run, it leads to a higher domestic inflation, reduced competitiveness and thus greater imports.
 - (ii) Smith argued that the size of the global economic pie is not constant and that trade between the two countries allowed the nations to take advantage of specialisation and division of labour, thus increasing productivity and higher world output.

3. THE EXAMINATION

The examination paper consists of two sections. Question 1 in section A is compulsory and students must answer three 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.

4. PRESCRIBED MATERIAL FOR THE EXAMINATION

You will be examined on any of the prescribed chapters outlined in 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 2017 EXAMINATION PAPER

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

Alle studente moet vrae 1 en 2 uit afdeling A beantwoord.

QUESTION 1 (a)

VRAAG 1 (a)

Globalisation has meant that countries are increasingly dependent on each other. The USA is one of South Africa's largest trading partners. Explain how the South African economy will be affected by a contraction of the American economy. (15)

Globalisering beteken dat lande toenemend meer afhanklik van mekaar raak. Die VSA is een van Suid-Afrika se grootste handelsvennote. Verduidelik hoe die Suid-Afrikaanse ekonomie deur 'n inkrimping van die Amerikaanse ekonomie geraak sal word. (15)

Note that this should be a comprehensive discussion of the positive impacts and any negative impacts that may be experienced in the South African economy as a result. This is strictly an introductory trade question; it does not require explanation or application of trade theories.

Let daarop dat dit 'n breedvoerige bespreking moet wees van die positiewe en negatiewe impakte wat die Suid-Afrikaanse ekonomie kan ervaar. Hierdie vraag is slegs 'n inleidende handelsvraag; geen toepassing of verduidelik van handelsteorieë word verlang nie.

QUESTION 1 (b)

VRAAG 1 (b)

There are ten (10) multiple-choice questions (MCQs) that must be answered by either marking the correct answer with an X, or circling it. Each question is worth 1 mark.

Daar is tien (10) meerkeusevrae wat beantwoord moet word deur die korrekte opsie te merk met 'n X, of dit te omkring. Elke vraag tel 1 punt.

1. The effect of a stimulation of the economy of the USA, one of South Africa's largest trading partners, on the South African economy is
- [1] an increase in South Africa's interest rate
 - [2] an increase in South African imports from the USA
 - [3] a decrease in South African exports to the USA
 - [4] an increase in South African exports to the USA

You are given the following information about production relationships in South Africa and Zambia. Use the table below to answer questions 2 and 3 that follow.

Country	Inputs per unit of copper output	Inputs per unit of gold output
South Africa	100	10
Zambia	20	60

2. Which of the following statements are correct?
- [1] Zambia has an absolute advantage in the production of gold.
 - [2] South Africa has an absolute advantage in the production of copper.
 - [3] South Africa has an absolute advantage in the production of copper and an absolute disadvantage in the production of gold.
 - [4] Zambia has an absolute advantage in the production of copper and South Africa has an absolute advantage in the production of gold.
3. According to the theory of comparative advantage,
- [1] South Africa should export gold.
 - [2] South Africa should export copper.
 - [3] Zambia should export copper and South Africa should export gold.
 - [4] Zambia should export gold and South Africa should export copper.
4. According to the H-O model, with international trade
- [1] the production of a nation's export products will decrease
 - [2] the production of a nation's import-competing products will decrease
 - [3] the price of the scarce factor of production will increase
 - [4] the price of the abundant factor of production will decrease
5. Assume capital is specific to two industries within South Africa and labour is freely mobile between the two industries, one capital intensive and the other labour intensive. Assume that South Africa is a labour-abundant country. With free trade, one would expect that
- [1] capital employed in both industries benefits while labour employed in both industries loses
 - [2] capital employed in both industries loses while labour employed in both industries gains
 - [3] labour and capital employed in the labour-intensive industry lose while labour and capital employed in the capital-intensive industry gain
 - [4] labour and capital employed in the labour-intensive industry gain while labour and capital employed in the capital-intensive industry lose

6. Should a small country impose a tariff on imported goods, a correct expectation is that
- [1] domestic output and domestic price will decrease
 - [2] domestic output and domestic price will increase
 - [3] domestic output will increase and domestic price will decrease
 - [4] domestic output will decrease and domestic price will increase
7. Assume that the domestic price of beef in South Africa is R199 per kilogram of beef imported. The price of a kilogram of beef in Tanzania is R100. Then South Africa forms a custom union with Botswana, where beef costs R145 per kilogram to import. This is an example of
- [1] intra-industry trade
 - [2] trade creation
 - [3] trade diversion
 - [4] trade evasion
8. The cooperation between nations that allows for the free movement of factors of production is known as a
- [1] free trade area
 - [2] common market
 - [3] customs union
 - [4] preferential trade agreement
9. The international trade agreement formed to ensure freer trade through multilateral trade negotiations is known as
- [1] WTO.
 - [2] ITO.
 - [3] ILO.
 - [4] GATT.
10. Which one of the following correctly explains the concept of transfer pricing?
- [1] Jax, a car manufacturing company based in South Africa, under-prices the components it exports to its affiliate in Nasinland, a low-tax nation.
 - [2] Jax, a car manufacturing company based in South Africa, over-prices the components it exports to its affiliate in Nasinland, a low-tax nation.
 - [3] Jax, a car manufacturing company based in South Africa, under-prices the components it imports from its affiliate in Nasinland, a high-tax nation.
 - [4] Jax, a car manufacturing company based in South Africa, over-prices the components it imports from its affiliate in Nasinland, a high-tax nation.
11. Die uitwerking van 'n stimulus op die ekonomie van die VSA, een van Suid-Afrika se grootste handelsvennote, op die Suid-Afrikaans ekonomie is

- [1] 'n toename in Suid-Afrikaanse rentekoers
- [2] 'n toename in Suid-Afrika se invoere vanuit die VSA
- [3] 'n afname in Suid-Afrikaanse uitvoere na die VSA
- [4] 'n toename in Suid-Afrikaanse uitvoere na die VSA

U ontvang die volgende inligting rakende produksieverwantskappe in Suid-Afrika en Zambië. Gebruik die onderstaande tabel om vrae 2 en 3 te beantwoord.

Land	Insette per eenheid koperuitset	Insette per eenheid gouduitset
Suid-Afrika	100	10
Zambië	20	60

12. Watter van die volgende stellings is korrek?

- [1] Zambië het 'n absolute voordeel in die produksie van goud.
- [2] Suid-Afrika het 'n absolute voordeel in die produksie van koper.
- [3] Suid-Afrika het 'n absolute voordeel in die produksie van koper en 'n absolute nadeel in die produksie van goud.
- [4] Zambië het 'n absolute voordeel in die produksie van koper en Suid-Afrika het 'n absolute voordeel in die produksie van goud.

13. Volgens die teorie van vergelykende voordeel behoort

- [1] Suid-Afrika goud uit te voer.
- [2] Suid-Afrika koper uit te voer.
- [3] Zambië koper uit te voer en Suid-Afrika goud uit te voer.
- [4] Zambië goud uit te voer en Suid-Afrika koper uit te voer.

14. Volgens die H-O-model, met internasionale handel sal

- [1] die produksie van 'n land se uitvoergoedere afneem
- [2] die produksie van 'n land se invoermededingende produkte afneem
- [3] die prys van die skaars produksiefaktor toeneem
- [4] die prys van die volop produksiefaktor afneem

15. Neem aan dat kapitaal spesifiek tot twee industrieë in Suid-Afrika is en arbeid vrylik tussen die twee industrieë beweeg; een kapitaalintensief en die ander arbeidsintensief. Neem aan dat Suid-Afrika 'n arbeid-oorvloedige land is. Tydens vryhandel kan daar verwag word dat

- [1] kapitaal aangewend in beide industrieë bevoordeel word, terwyl arbeid aangewend in beide industrieë benadeel word
- [2] kapitaal aangewend in beide industrieë benadeel word, terwyl arbeid aangewend in beide industrieë bevoordeel word
- [3] arbeid en kapitaal wat in die arbeidsintensiewe industrie aangewend word, benadeel word, terwyl arbeid en kapitaal wat in die kapitaalintensiewe industrie aangewend word, bevoordeel word

- [4] arbeid en kapitaal wat in die arbeidsintensiewe industrie aangewend word, bevoordeel word, terwyl arbeid en kapitaal wat in die kapitaalintensiewe industrie aangewend word, benadeel word
16. Indien 'n klein land 'n invoertarief op ingevoerde goedere hef, is die korrekte verwagting dat
- [1] plaaslike uitset en plaaslike prys sal afneem
 [2] plaaslike uitset en plaaslike prys sal toeneem
 [3] plaaslike uitset sal toeneem en plaaslike prys sal afneem
 [4] plaaslike uitset sal afneem en plaaslike prys sal toeneem
17. Gestel die plaaslike prys van beesvleis in Suid-Afrika is R199 per kilogram ingevoerde beesvleis. Die prys van 'n kilogram beesvleis in Tanzanië is R100. Dan vorm Suid-Afrika 'n doeane-unie met Botswana, waar beesvleis R145 per kilogram kos om in te voer. Hierdie is 'n voorbeeld van
- [1] intra-industriehandel
 [2] handelskepping (*trade creation*)
 [3] handelsverspreiding (*trade diversion*)
 [4] handelsvermyding (*trade evasion*)
18. Die samewerking tussen state wat toelaat dat produksiefaktore vrylik kan beweeg, staan bekend as 'n
- [1] vryhandelsgebied
 [2] gesamentlike mark
 [3] doeane-unie
 [4] voorkeurhandelsooreenkoms
19. Die internasionale handelsooreenkoms wat gestig is om vryer handel deur multilaterale handelsamesprekings te verseker staan bekend as
- [1] WTO.
 [2] ITO.
 [3] ILO.
 [4] GATT.
20. Watter een van die volgende verduidelik die konsep van oordragpryse (*transfer pricing*) korrek?
- [1] Jax, 'n Suid-Afrikaanse maatskappy wat voertuie vervaardig onderskat die pryse van onderdele wat uitgevoer word na 'n filiaal in Nasinland, 'n staat met lae belasting.
 [2] Jax, 'n Suid-Afrikaanse maatskappy wat voertuie vervaardig oorskot die pryse van onderdele wat uitgevoer word na 'n filiaal in Nasinland, 'n staat met lae belasting.
 [3] Jax, 'n Suid-Afrikaanse maatskappy wat voertuie vervaardig onderskat die pryse van onderdele wat ingevoer word vanaf 'n filiaal in Nasinland, 'n staat met hoë belasting.
 [4] Jax, 'n Suid-Afrikaanse maatskappy wat voertuie vervaardig oorskot die pryse van onderdele wat ingevoer word vanaf 'n filiaal in Nasinland, 'n staat met hoë belasting.

Solutions to question 1 a and b

Students must be able to talk about the following points:

The USA is one of South Africa's largest export destinations. A contraction of the American economy means that US imports from SA will decrease. When this happens, the South African economy will see a decrease in its exports to the US. This will decrease employment in the export industries, decrease South Africa's GDP and incomes and result in a fall in standard of living.

The decrease in US imports from SA will result in a decrease in the demand for the rand. This will result in a fall in the value of the rand. A lower rand has a positive effect on the country's export competitiveness, and may enhance exports, while at the same time making imports expensive. Depending on the dominant factor, SA might experience an improvement in its current account and balance of payment.

A contraction of the US economy can also decrease American firms' investments in South Africa through FDI. This has a number of drawbacks for an emerging economy like South Africa's, including decreased exports, low skills transfer, decline in capital investments, and so forth.

Question 1b

[1] 4	[5] 4	[9] 1
[2] 4	[6] 2	[10] 3
[3] 1 and 3	[7] 3	
[4] 2	[8] 2	

QUESTION 2**VRAAG 2**

You are told that South Africa can produce 200 tons of sugar using the same labour resource as Lesotho, who can produce 50 tons of sugar. Also using the same resource, South Africa can produce 6 million cars while Lesotho produces 2 million cars. Given this information, critically discuss the validity of the statement that "there are no gains to be made from trade between the two countries". **[25]**

U word meegedeel dat Suid-Afrika 200 ton suiker kan produseer deur gebruik te maak van dieselfde arbeidshulpbron as Lesotho, wat 50 ton suiker kan produseer. Deur ook gebruik te maak van dieselfde hulpbron, kan Suid-Afrika 6 miljoen motors produseer terwyl Lesotho 2 miljoen motors kan produseer. Gegewe hierdie inligting, bespreek krities die toepaslikheid van die stelling dat "handel tussen die twee lande geen voordeel inhou nie". **[25]**

Your discussion should be limited to the classical theories. All assumptions and criticisms must be included in your discussion.

Beperk u bespreking tot die klassieke teorieë. Alle aannames en kritiek moet by u bespreking ingesluit word.

QUESTION 3
VRAAG 3

QUESTION 3 (a)
VRAAG 3 (a)

Define the terms import tariff and export subsidies. (2)

Definieer die terme invoertarief en uitvoersubsidie. (2)

QUESTION 3 (b)
VRAAG 3 (b)

According to your understanding what is/are the main motives (reasons) for a country imposing a tariff or an export subsidy? Which of the two is considered more harmful to the economy?

So ver u kennis strek, wat is die vernaamste oorwegings (redes) waarom 'n land 'n tarief hef of 'n uitvoersubsidie instel? Watter een van die twee word as meer skadelik vir die ekonomie beskou?

QUESTION 3 (c)
VRAAG 3 (c)

Using well-drawn diagrams (in the space provided below), discuss the effects on a small nation when it imposes a tariff on goods coming into the country versus when it imposes an export subsidy. (25)

Bespreek deur gebruikmaking van toepaslike diagramme (in die gegewe ruimte hier onder) die gevolge wanneer 'n klein land 'n tarief hef op goedere wat die land binnekom, teenoor wanneer hy uitvoersubsidies instel. (25)

QUESTION 4
VRAAG 4

(a) Explain trade diversion and trade creation. (5)

Verduidelik handelsverspreiding en handelskepping. (5)

(b) Discuss the potential dynamic welfare gains that can result from the formation of a customs union. (10)

Bespreek die moontlike dinamiese welvaartsvoordele wat uit die stigting van 'n doeane-unie kan voortvloei. (10)

(c) Discuss the conditions that are likely to lead to increased welfare with the formation of a customs union. (10)

Bespreek die omstandighede wat waarskynlik tot 'n toename in welvaart sal lei indien 'n doeane-unie gestig word. (10)

Note that the solutions to question 1 has been provided. It is up to each student to work through the other questions and attempt to answer them. You should work through the rest as you prepare for the examination. Contact us if you need guidance.

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 that final-year students will 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