

EC3355 International Trade

Problem Set 9: Trade issues

1. Some economists argue that developing countries should be able to protect their own industries from foreign competition based on the terms-of-trade argument. What is the terms-of-trade argument and explain whether or not it is a good reason for protectionism?

Answer: The terms-of-trade argument is based on the optimal tariff rate which means that a country can set a particular tariff that increases welfare. This happens when the tariff is small enough that the ToT gains outweigh the trade distortion loss. This comes at the expense of the trading partners though. This argument is probably not a good reason for developing countries to influence trade as it only works for large economies which can actually influence their ToT as they are price setters and not takers.

2. Is domestic market failure a good argument for protectionist measures such as import tariffs?

Answer: Not entirely. It is unclear why protectionist measures are needed here rather than domestic policies that address the problem's sources directly.

3. Etkes and Zimring (2015) try to estimate the effect of trade on welfare and find that in their case study that the absence of trade leads to a reduction in welfare. What was their research design and which two mechanisms did they find that lead to the reduction in welfare?

Answer: See the lecture slides for the answer to this question.

4. You find yourself talking to someone who is very much anti-globalisation. This person argues that trade exploits workers and that the gains from trade are unequally distributed. Does globalisation indeed lead to more income inequality?

Answer: There is some empirical evidence that confirms the predictions of the HO-model that trade can lead to increased income

inequality. This is especially a relevant topic in the developed world where returns to capital have increased over time whereas returns to labour have stagnated (see the work by Piketty and Seaz). Returns to labour have increased in developing countries which has led to some convergence in global income. However, within-country differences are still large and there is some evidence that shows that returns to skilled labour have increased while there has been a decrease for unskilled labour.

5. One way in which trade negatively affects the environment is due to the emissions from transport. In order to reduce its carbon footprint the UK government therefore decides to ban the import of coffee and instead produce it locally. Is this a good idea?

Answer: This is not a good idea. Producing coffee in an unfavourable climate like the British climate will probably lead to higher emissions due to the use of greenhouses for instance.

6. Sweden produces a lot of paper due to its abundance of trees. The Netherlands also happen to produce paper. Due to environmental concerns the Dutch government decides that paper sold in the Netherlands must contain at least 30% recycled paper. What are the economic implications of this policy?

Answer: Although environmental concerns are cited as the reason for this policy there is probably a strong economic incentive here where the policy is just a trade barrier in disguise. The recycled paper requirement means the Sweden's comparative advantage vis-a-vis the Dutch producers is reduced, at least on the Dutch paper market.

7. The incident with the Probo Koala in 2006 has been blamed for the deaths of 17 and injury of more than 30,000 Ivorians. What role did comparative advantage play in this incident?

Answer: Environmental regulations were more flexible in Ivory Coast compared to Europe where the shipping company originally wanted to offload its toxic waste. In the port of Amsterdam they had to pay €1,000 per cubic meter of disposal (note they had 500 tonnes of waste). In Abidjan they only had to pay €18,500.

8. The study by Lin et al. (2014) showed that Chinese trade growth has been an important source of air pollution in the past decade with a strong increase in various pollutants such as sulphate and black carbon. Do you think that on the mid-term (10-20 years) Chinese economic development will continue to increase air pollution? Explain why or

why not?

Answer: It depends a bit where China is at the moment on the environmental Kuznet's curve. Recent developments seem to be positive though.

9. The tragedy of the commons deals with the eventual depletion of a resource due to over-use. This theory is linked to the demise of Easter Island as well as collapse of fish stock. It has also been linked to the current economical dependence on oil. Explain from an economic perspective whether oil is a finite resource or not.

Answer: It is not from an economic perspective. This article gives an interesting explanation and is a must-read.

10. Whether the tragedy of the commons is true or not is a hotly debated topic. What is your take on this?