**International Economics**

Home assignment 10: Export and Production subsidies

**Question 1:**

Suppose that Home is a small exporter of wheat. At the world price of $100 per ton, Home exports 20 tons. Now suppose that the Home government decides to support its domestic producers with an export subsidy of $40 per ton. You may assume that demand and supply curves are linear.

|  | With Subsidy | Free Trade |
|---|---|---|
| World price | $100 | $100 |
| Domestic price | $140 | $100 |
| Domestic consumption | 10 | 20 |
| Domestic production | 50 | 40 |

Draw a diagram to illustrate the effects of export subsidy.

Calculate the effect of the export subsidy on CS, PS and government revenue.

Calculate the overall net effect of the export subsidy on Home welfare.

**Question 2:**

Now suppose that Home is a large country. Suppose that the Home government provides the domestic producers with an export subsidy in the amount of $40 per ton.

|  | With Subsidy | Free Trade |
|---|---|---|
| World price | $80 | $100 |
| Domestic price | $120 | $100 |
| Domestic consumption | 15 | 20 |
| Domestic production | 45 | 40 |

(a) Relative to the small-country case, why does the new domestic price increase by less than the amount of subsidy?

(b) Draw a diagram and calculate the effect of the export subsidy on CS, PS and government revenue.

(c) Calculate the overall net effect of the export subsidy on Home welfare. Is the large country better or worse off as compared to the small country with the export subsidy?

**Question 3:**

Refer to Question 1.

Rather than an export subsidy, suppose the Home government provides its domestic producers with a production subsidy of $40 per ton.

|                      | With Subsidy | Free Trade |
|----------------------|--------------|------------|
| World price          | $100         | $100       |
| Domestic price       | $140         | $100       |
| Domestic consumption | 20           | 20         |
| Domestic production  | 50           | 40         |

Calculate the effect of the production subsidy on CS, PS and government revenue.

Calculate the overall net effect of the production subsidy on Home welfare. Is the social cost of the production subsidy larger or smaller than the social cost of the export subsidy for the small country?