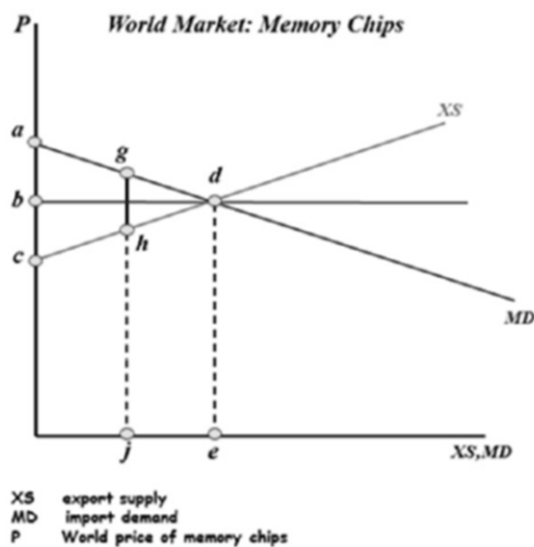


Homework Exercises 1

Courtesy of **Gaaitzen de Vries**

Course material: Ch 1.4-1.8 & Ch 3.1-3.3

1. Multinational companies that adopt the same standards for their branches all over the world is a clear example of what type of globalization?
2. Describe what is meant by geographic globalization.
3. Some people argue that because of globalization, location no longer matters. Give an example that supports this argument and an example that contradicts it.
4. If a country has an absolute advantage in the production of a good, must it also have a comparative advantage in that good? Explain.
5. Consider the following graph, which shows trade equilibrium on the world market for memory chips at point *j*. The price wedge is caused by transportation costs. Assume that demand for memory chips increases in the exporting country, other things being equal.



Draw graphs for the exporting and the importing countries. Indicate the volume of exports in the graph for the exporting country and the volume of imports in the graph for the importing country in case of the existence of the price wedge. Find the new equilibrium after the increase in demand for memory chips in the exporting country.

What are the consequences for:

- a. The world price of memory chips.
- b. The price wedge.
- c. World welfare.
- d. Deadweight losses of the exporting country.

Indicate your answers on the graphs.

6. The following table provides data on labour productivity for two countries, the US and the EU, in the production of Cloth and Wine.

Labour productivity; Units of output per hour

	Cloth	Wine
US	3	6
EU	9	9

- a. Explain, using the data in the table, what the difference is between “absolute” and “comparative” cost advantage.
 - b. Assume that the EU and the USA engage in free trade. What will the pattern of international trade be (*i.e.*, what good will each country export and what will it import)?
 - c. As a result of globalization a country can experience a decline in employment in a sector in which it has a greater productivity than its trading partner. Explain using the table above in which sector this will occur for the EU and discuss why it need not lead to a national welfare loss.
7. The CEO of an American car manufacturer complains that its firm is at least as competitive as its Japanese rival yet it is still losing market share. Explain why the process of specialization according to comparative advantage may seem unfair to individual firms.

Answers

1. Institutional globalization. This relates to the spread of universal institutional arrangements across the globe.
2. This refers to the sensation of compressed time and space as a result of reduced travel times between locations and the rapid exchange of information.
3. On the one hand, location is not important anymore, because capital can flow across borders. Examples include cross-border mergers and acquisitions. On the other hand, location becomes even more important, because local interconnections are required to gain a competitive advantage in a more competitive environment. Examples are the clustering of international finance in three global centers (London, NY, Tokyo).
4. No, comparative advantage refers to the relative efficiency of producing a good. Once a country opens up to trade it might specialize in another good in which it is relatively more efficient.
5. Use graphs during the tutorial to show that as a result:
 - a. Goes up
 - b. The price wedge stays the same.
 - c. Goes down.
6.
 - a. The EU has an absolute cost advantage for both goods, because labour productivity in the EU is higher for both goods. However, the EU has a comparative advantage in the production of cloth as it is three times more efficient in the production of cloth compared to 1.5 times more efficient in the production of wine. The EU is therefore relatively most efficient in the production of cloth.
 - b. The US will export wine, whereas the EU will export cloths.
 - c. This is the wine sector in the EU. Its productivity is higher compared to the US, but because of international trade, the EU will specialize in the production of cloths. Overall welfare may increase as world production of both goods goes up.
7. A firm could lose market share if another sector in the economy is relatively more productive than the car industry. In the theory of comparative advantage, even if a firm is more productive than a foreign counterpart, it may still lose market share because other domestic firms might have a higher productivity advantage relative to foreign firms than the firm that loses market share.