

## Hand-out week 4

### **This week:**

2. New Trade: increasing returns to scale, the monopolistic competition model, intra-industry vs. inter-industry trade.
4. Trade Policy:
  - 4.1. the case of a small country: tariffs, quotas, voluntary export restraints, export subsidies.
  - 4.2. the large country case: trade policy and optimal tariffs.
  - 4.3. political economy considerations.

**Readings:** Krugman&Obstfeld, chpts 6, 8, and 9.

### **Practice problems:**

1. Consider a 2x2 production side with equal factor intensities in both sectors. Derive the PPF for the case of increasing returns to scale (feel free to do it for DRS and CRS as well). Suppose consumption has to be on the 45 degree line, show the gains from trade when two identical countries trade with each other. What's wrong with the initial autarky "equilibrium" though?
2. K&O problems 6.2 and 6.4
3. Explain the difference between intra-industry and inter-industry trade. Which kind of trade is explained by the old, which by the new trade theory? How could you measure the degree of intra vs inter-industry trade? Go to [www.ita.doc.gov/td/industry/otea/usfth/geoarea/rworld.txt](http://www.ita.doc.gov/td/industry/otea/usfth/geoarea/rworld.txt) and actually calculate this measure for sectors SITC 0 thru 9 using the data for 2000.
4. K&O problems 8.7 and 8.1.-8.4.