Final Exam

This is a 60 min exam. There are three equally wighted questions. Please read them carefully, and answer each of them. If you have questions please do ask. *Good luck !*

Question 1: Ricardian Trade. Consider the following table of unit labor input requirements:

	Malaysia	Singapore
durian	$a_d^{MY} = 3$	$a_d^{SG} = 2$
rickshaw	$a_r^{MY} = 120$	$a_r^{SG} = 60$

a) In a traditional Ricardian model, explain which country will export which commodity, and what value you expect for the relative equilibrium wage (wage in Singapore over wage in Malaysia).

b) Explain in detail, by pointing out the pertinent assumptions, how Dornbusch, Fisher, and Samuelson (AER 1977) generalize the model to many commodities, and how Eaton and Kortum (EM 2002) generalize it further to many countries.

Question 2: Factor Mobility.

a) Consider the Heckscher-Ohlin model of trade. What happens in this model if international factor mobility is allowed — either for one or for both factors? Does your answer change depending on whether the initial situation lies within or outside the cone of diversification?

b) The new economic geography literature tends to use a monopolistic competition framework. Explain the concepts of 'forward' and 'backward' linkages that arise in the context of this model. In addition, depict and explain the tomahawk diagram.

Question 3: New (new) trade — the monopolistic competition model.

a) Describe the Dixit-Stiglitz-Krugman monopolistic competition trade model and state its main equations. Explain why it is able to account for intra-industry trade whereas the 'old' trade theory was not.

b) Describe in detail how Melitz extends the monopolistic competition trade model to allow for heterogeneous firms, and explain the effects of a decrease in trade costs on the profits of individual firms and the equilibrium productivity thresholds in this model.