Public Affairs 856 | Menzie D. Chinn
Spring 2019 | Social Sciences 7418
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Problem Set 3

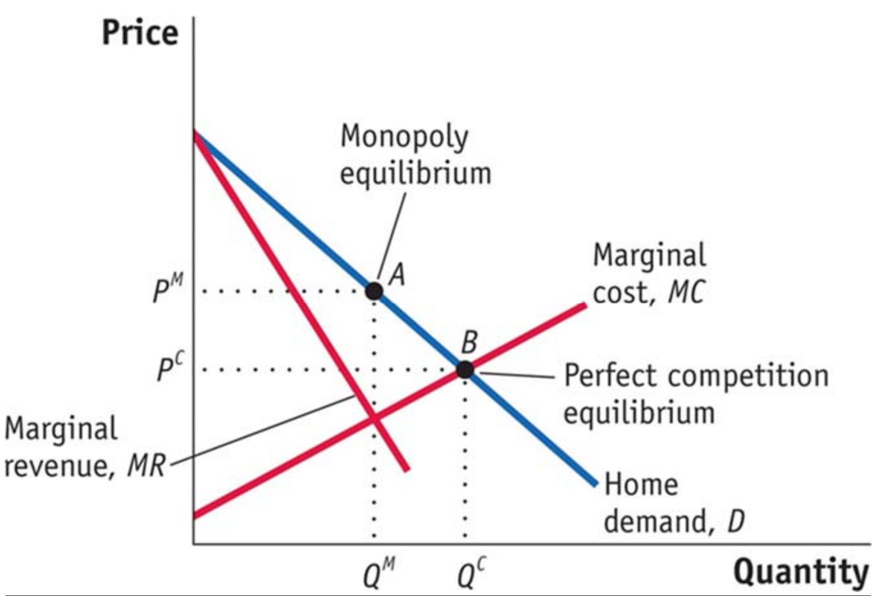
Due in Lecture on Monday, April 8th.

1. Starting from the long-run trade equilibrium in the monopolistic competition model, as illustrated in Figure 6-7, consider what happens when industry demand, D, increases. For instance, suppose that this is the market for cars and lower gasoline prices generate higher demand D.
1.1 Redraw Figure 6-7 for the home market and show the shift in the D/NT curve and the new short-run equilibrium.
1.2 From the new short run equilibrium, is there exit or entry from the market, and why?
1.3 Describe where the new long-run equilibrium occurs, and explain what has happened to the number of firms, and the prices they charge.

2. Consider a small country applying a tariff, *t*, to imports of a good.
2.1 Suppose that the country decides to reduce the tariff to *t'*. Using a graph, show what happens to production at home, what happens to imports?
2.2 Show the changes to consumer and producer surplus.
2.3 Show the changes to government revenue.
2.4 Show the overall change to welfare.

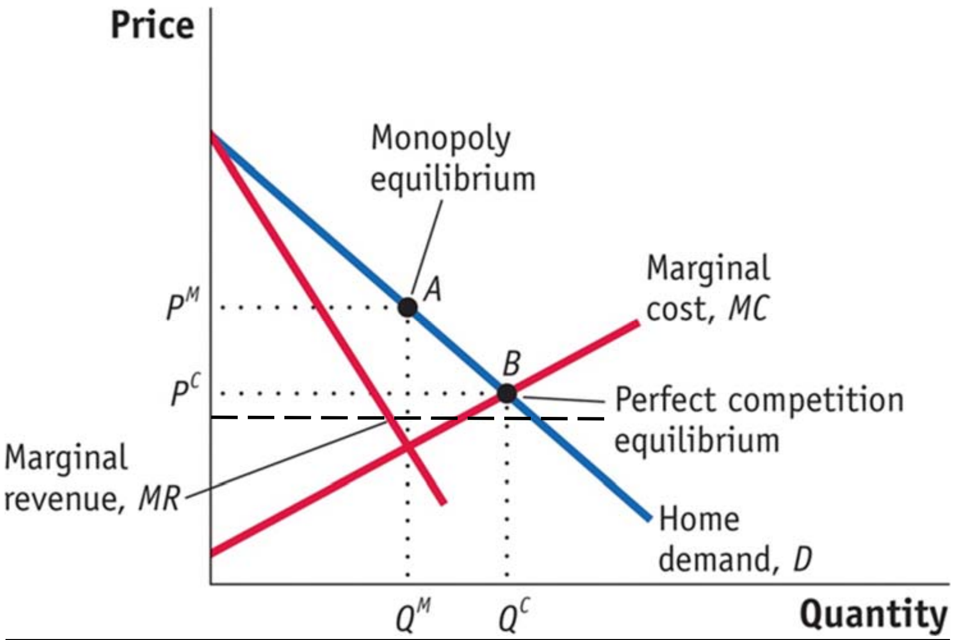
3. Consider a large country. Compare a tariff that is large vs. one that is small. In which case is the terms of trade gain likely to exceed the dead weight loss? Show using graphs.

4. Consider the following monopoly in an autarkic country:



4.1 Show consumer surplus under perfect competition. Show producer surplus.
4.2 Show consumer surplus under monopoly. Show producer surplus.
4.3 Show deadweight loss (DWL) due to monopoly.

5. Assume the economy in Problem 3 opens up to international trade. The world price is shown by the horizontal dashed line. Show the gains from trade.



~~6. Consider a small country that exports widgets. Suppose the marginal social cost of widget production is less than the marginal (private) cost.~~
~~6.1. Show what happens if an export subsidy of z is applied.~~
~~6.2 Show what happens if a production subsidy of z is applied (same amount as in 6.1)~~
~~6.3 Which policy is preferable? Explain why?~~