

ECO 2121 A: Economics of Globalization
16 February 2015
Sample practice questions

Question 1

Based on the World Bank data, the following is the situation of some selected countries.

	Value in US\$ billions				
	GDP	GNI	X-M	CA	S
Canada	1,736	1,706	-21.3	-53.0	374.8
France	2,773	2,825	-77.9	-54.4	494.4
Germany	3,601	3,668	182.9	203.6	840.5
Italy	2,194	2,177	-32.5	-67.4	399.0
Japan	5,867	6,042	-53.9	119.1	1,111.7
United Kingdom	2,445	2,470	-38.7	-34.3	325.5
United States	14,991	15,211	-568.1	-465.9	1,667.8

- a. Compute net factor income from abroad in each country?
- b. Compute net unilateral transfer for each country?
- c. Calculate gross national disposable income.
- d. Compute the gross national expenditure for all countries.
- e. What is the gross domestic investment for these countries?
- f. Can you say which countries are net lenders and which are the net borrowers?
- g. What will be the sum of FA and KA for these countries?
- h. If a country has CA surplus (assuming that capital account is zero), what does it imply to its income and expenditure and borrowing and lending?
- i. In this case, what happens to financial account and why? What happens to external wealth of such country?
- j. What are the three major types of financial flows recorded in financial account?

Question 2

Suppose there are only two countries and only one factor of production, labor, and these two countries produce only two goods, Ipad and cloth. The labor productivity (output per unit of labor) in two countries for the production of two goods is as given below.

Labor productivity (output per labor)

	Ipad	Cloth
Home	$LP_I = 4$ units/labor	$LP_C = 12$ units/labor
Foreign	$LP^*_I = 2$ units /labor	$LP^*_C = 8$ units/labor

Note that labor productivity is denoted by LP and Ipad and cloth are indicated by subscripts of I and C, respectively. The variable with an asterisk is a foreign variable.

- a. How do you define opportunity cost? What is the opportunity cost of Ipad and cloth production for Home and Foreign countries? Show the calculation and explain what these numbers mean?
- b. What is comparative advantage and which country has comparative advantage in the production of which good?

- c. Suppose that in both countries there is perfect competition in the sense that nominal wage of a unit of labor is equal to its value of production, and both goods are produced. Show that in pre-trade situation, relative price of Ipad in terms of price of cloth (P_I / P_C) must be equal to the opportunity cost of producing Ipad. Show it for both countries.
- d. Using these pre-trade relative prices in two countries, explain why Home producers have incentive to export Ipad.
- e. Let us suppose that world relative price of Ipad (p_I^w / p_C^w) is 3.5 (= \$3.5/\$1). Show that Home is better off producing only Ipad and exporting it and Foreign is better off producing only cloth and exporting it.
- f. If specialization occurs what would be the wages in two countries? Why is the case that the prices of goods are equalized but not the wages between two countries?

Question 3

- a. In its basic form, what is gravity model of trade and what is the rationale of this model?
- b. Can you think of any factors that determine trade flows between Canada and US except the basic gravity variables?
- c. What is “border effect”, explain with examples.

Question 4

- a. What are the main forces of globalization? How has been their pace in recent decades?
- b. What are the potential benefits and costs of foreign direct investment (FDI)?
- c. How have trade flows changed between developed and developing countries and what are the reasons for these shifts? What is the role of BRIC?
- d. What is your assessment of Canada’s trade performance vis-à-vis other G6 countries? What are the challenges and the opportunities that Canadian traders are facing?
- e. How rare and concentrated is trading activities in Canada? Why do you think this is the case?