

FRE 306 (2017): Problem Set #1

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2nd.Oct.2017

1.

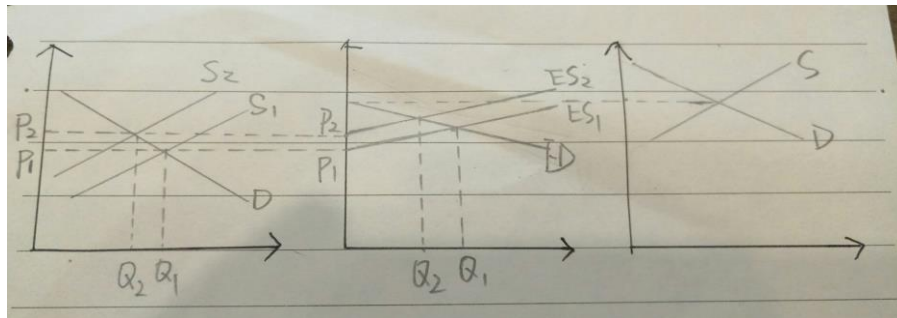
$$\text{Real Price} = (\text{Nominal Price} / \text{Current CPI}) * (\text{Base CPI})$$

Base CPI= 2009 CPI= 120.3

| Year | Nominal Price | CPI | Real Price (2009 dollars) |
|---------|---------------|-------|---------------------------|
| a. 1989 | 0.25 | 64.9 | 0.46 |
| b. 1994 | 0.39 | 82.1 | 0.57 |
| c. 1999 | 0.45 | 100.0 | 0.54 |
| d. 2004 | 0.51 | 107.3 | 0.57 |
| e. 2009 | 0.54 | 120.3 | 0.54 |

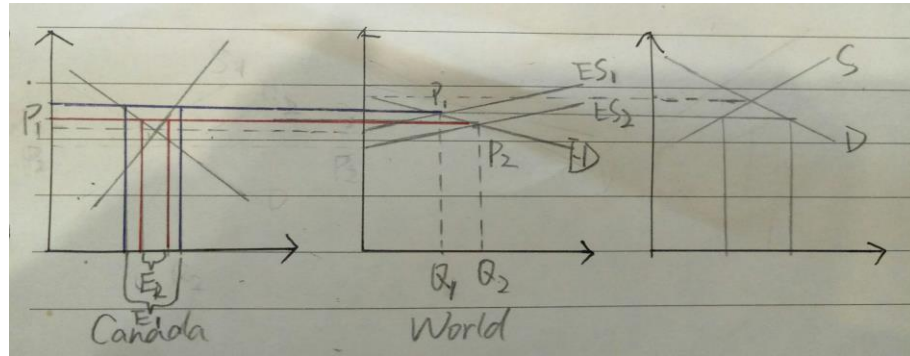
2.

- a. Because domestic lentil production decrease, the supply decrease and the supply curve of Canada (export country) have a left shift (S_1 to S_2). That makes excess supply curve shift left too (ES_1 to ES_2) and world price higher and worldwide trade volumes lower.

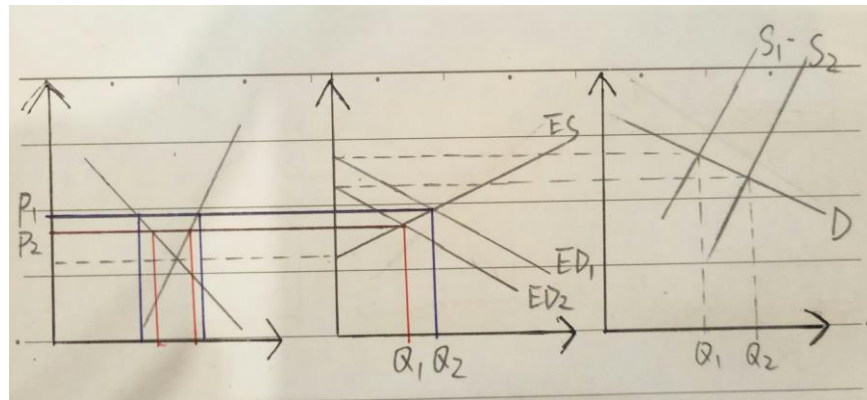


- b. It depends on the size of Ethiopia export quantity. Because become top 5 exporters doesn't mean have export quantity as large as Canada. So it became two different situations:

- 1) Ethiopia increase export quantity a lot to become one of main world exporter, have influence to world market. Then makes supply increase and ES curve shift right (ES1 to ES2). World price go down and as a result Canada produce quantity decrease, domestic demand increase. Finally, Canada export fall.



- 2) Although Ethiopia increase productivity, it still too small compare to Canada. So Canada still the only one can influence the world price. As this case, Ethiopia still the one of the import country, it shifts import country supply curve to right, and cause ED curve shift left (ED1 to ED2). Finally, world price fall and reduce Canadian export quantity.



- c. Because Canada is small country in world lentil consumption market, so it makes very little influence in world demand. Although domestic consumption increased, the price will not be change.

3.

(a)

Because A to B have trade, we can compare PA – PC and PC – PB separately.

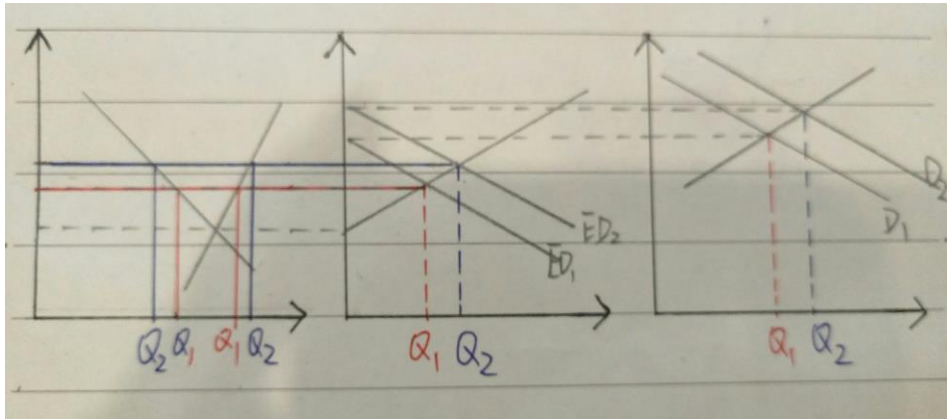
- 1) If P_C is lower than P_A , then there will be trade from C to B. So $P_C > P_A$.
 - 2) If P_B is lower than P_C , then there will be trade from A to C. So $P_B > P_C$.
- In conclusion, $P_B > P_C > P_A$.

(b)

From (a) we know P_A to P_B is 100, for making trade from C to B, the price between C and B must higher than shipment cost, which means at least 1 can make export from C to B.

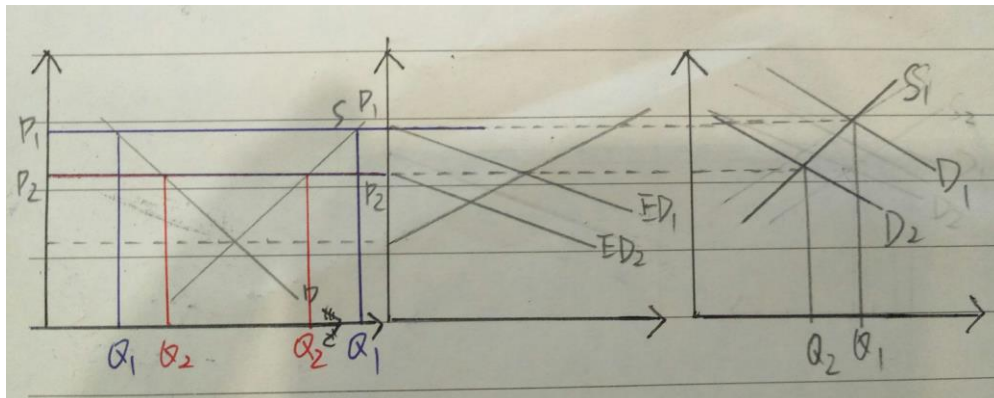
4.

- (a) As we can see from the picture, although there is only 10% increase in Chinese demand (D_1 to D_2), but China is a large population country and NZ is a small population country, so the demand of quantity actually increases a lot and have significant influence to world trade. So the result of trade will increase much more times than 10% increase in Chinese demand.



(b)

As we can see from the diagram, 10% decrease in the value of the Chinese yuan means people need to spend more money to buy a same milk powder. That would decrease China domestic demand (D_1 to D_2) and China domestic supply not change. As a result, in world market ED curve shift to left from ED_1 to ED_2 . Import quantity reduce. That also cause large reduction of NZ export quantity.



5.

- a) False. Normal goods have income elasticity which is positive, and inferior goods have income elasticity which is negative, and both of them regardless of high or low-income elasticity.