Faculty of Economics and Business Universitas Indonesia (FEBUI)
Undergraduate Regular (S1 Regular)

Midterm Exam
Odd Semester 2017/2018
Economics International (ECEU603200)
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Open Book and Open Notes
180 Minutes

1. “If there were free migration and truly open borders, workers from the lower-wage countries would stream into the higher-wage countries. These new arrivals would compete for jobs, accept work for lower pay, and force the existing jobholders to accept either lower wages or unemployment. Precisely for this reason, no one accepts or supports the notion of free immigration. “We do, however, accept and support the notion of free trade, which has the same effect. Instead of exporting workers to the United States, lower-wage countries simply import our jobs and industries to their workers. As the higher-wage nation suffers cutbacks in production, failures of companies, and losses of jobs, the market dictates that workers accept lower wages and a reduced standard of living to match the lower-wage foreign competition.” – Professor John Culbertson, University of Wisconsin, writing in the Harvard Business Review, September-October 1986. Explain the economic reasoning in this argument and assess its validity.(25 points)

2. The United States has gotten a head start in producing scientific word processing software, and now supplies the world market. There are external economies of scale in the software industry. Investors in India believe India has the natural comparative advantage in software production, and insist that India is worse off under free trade than under autarky. In the space below, please draw a very carefully-labeled graph that illustrates a situation in which the Indian investors are only half correct: although India has a natural comparative advantage in producing this software, India nevertheless is better off importing software from the country that got the head start in the industry (United States) than in autarky. (25 points)

Kanopi FEBUI
Unity in Development

3. Is free trade a sufficient condition for growth and poverty alleviation in developing countries? Critically evaluate how recent trade liberalization experience in some Asian countries has influenced their economic growth and poverty.

4. “Consider two countries producing the same good with the same constant returns to scale production function, relating output to homogeneous capital and labor inputs. ... the Law of Diminishing Returns implies that the marginal product of capital is higher in the less productive (i.e., in the poorer) economy. If so, then if trade in capital good is free and competitive, new investment will occur only in the poorer economy, and this will continue to be true until capital-labor ratios, and hence wages and capital returns, are equalized.” – Robert E. Lucas, American Economic Review, 1990. Within the set-up of Lucas' statement – output produced by capital and labor with constant returns to scale and the same technology being accessible to all countries – how can our models of international trade explain why capital flows do not occur the way Lucas argues they should?