Assignment #5
Due Date: Tuesday, December 5
Beginning of Class

1. A small country can import a good at a world price of 10 per unit. The domestic supply curve of the good is: $S = 50 + 5P$
   The demand curve is $D = 400 - 10P$

   In addition, each unit of production yields a marginal social benefit of 10.
   (a) Calculate the total effect on welfare of a tariff of 5 per unit levied on imports.
   (b) Calculate the total effect of a production subsidy of 5 per unit.
   (c) Why does the production subsidy produce a greater gain in welfare than the tariff?
   (d) What would the optimal production subsidy be?

2. Suppose that ABC is a Taiwanese firm, and XYZ is a Korean firm. The following payoffs result, depending on the firm decisions. What equilibrium, and what payoffs will result if there is no government intervention?

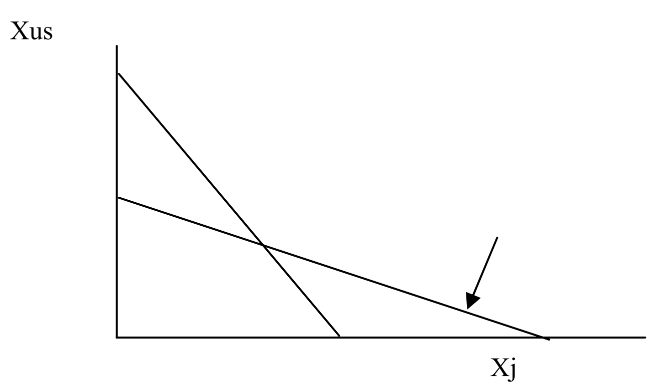
ABC \ XYZ	Produce	Not Produce
	-40,25	60,0
	0,150	0,0

3. Strategic trade. The cost for production is 3,000 per car in the US and 2,000 per car in Japan. Suppose automobile prices are described by the following inverse demand function:

$P = 60{,}000 - 20(Xus + Xj)$

(a) Derive the reaction function for US producers. IE Xus(xj), express the number of US cars produced as a function of Japanese production.

Now consider the reaction functions graphed below and use them to answer the questions b and c.



(b) Which reaction function does the arrow point to? Xus(Xj) or Xj(Xus)?
(c) What factors may cause any US strategic trade policy attempts to fail? List 2.