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Econ 280—Bethany College

**Homework 07**

Answer all the following on a ***typed, stapled*** (if applicable)separate sheet of paper. You do not need to type equations and graphs. I charge 25 cents to staple your homework. Make sure that you justify your answers, use your own words, and show your work. All questions are equally weighted.

1. North Korea is the most isolated countries on the planet. For over sixty years, its citizens have been largely cut off from all outside influences while its government maintains a military dictatorship so oppressive, it resembles George Orwell’s *1984*. Once a unified peninsula with a common language and culture, the differences between communist North and capitalist South are now tremendous. (For example, South Korea’s GDP per capita is more than ten times North Korea’s.) Imagine the dictatorship collapsed and peninsula reunified under the South Korean government. Trade and investment with the North was now possible. But because of its communist history property rights are tenuous.

Suppose you built a mine in the North to take advantage of the cheap labor and abundant mineral resources. But because of poorly enforced property rights, the mine is a commons, where the locals could share in the harvesting of the resource. Because of that, you decide to organize the mine as a commons, where the community harvests ore and you pay each worker for ore that person harvests. They consult you on how best for them to set up their communal mine. Being as specific as possible (perhaps with hypothetical examples), advise the community using one of Elinor Ostrom’s design principles and justify your advice with reference to the importance of local knowledge.

*With eight principles, there are many ways to approach this problem. Here are some possible answers.*

*Consider clearly defined boundaries. Note that while the boundaries are clearly defined, that doesn’t mean it’s not a commons. Such a boundary could (and would) encompass many people, all of whom have a vested interested in protecting the mine because all of them could harvest from it. The CPR should have clearly defined boundaries because otherwise it would be difficult for local people to properly manage if any investments are worth the effort since they couldn’t easily determine how much they, personally, would benefit from the mine. Local knowledge is particularly important since only local people are familiar with who could be considered an “outsider” and would be in a position to detect them.*

*Consider congruence between rules and conditions. If their rules didn’t match local conditions on the ground—such as lower workloads during colder times of the year or randomly allocating access if a small but rich vein has been discovered recently—then the CPR would collapse as people would feel the need to cheat due to poor information access. These conditions are, by their nature, locally known and thus only those with the specific knowledge about the particular and changing conditions are in a position to properly create these rules.*

*Consider graduated sanctions. Punishment must be proportional to the violation lest you either (a) encourage big betrayals because the punishment is too strong or (b) discourage involvement because the punishment is too large. For example, taking an ounce extra of ore should not have the same punishment as taking a pound extra. Exactly what constitutes a properly weighed sanction depends on the local preferences and constraints of the people, as well as changing circumstances (for example, if an illness strikes the community, then allowing people to cheat a little more is better tolerated since others wouldn’t be able to harvest that ore, anyway).*

1. We discussed complications with antidumping laws. Select one of those issues and indicate why it complicates the goals of AD laws.

*There are many possible answers to this question. One could point to how difficult it is to determine if a firm is actually dumping (pricing below cost) since prices and costs vary for many reasons. Price discrimination complicates AD laws: prices might be very low compared to other countries because consumers are more sensitive to price. Thus the firm might be pricing below average cost, but not marginal cost. Yet the Commerce Department cares only about comparative prices without regards to this difference in pricing.*

*One could also turn to the beef-hides problems. When the Commerce Department calculates a “fair” price for a good, they estimate the cost of the good. But firms make many different goods and some of what it does enables the production of many different goods. How much of such costs goes to one good versus the other? It is impossible to tell.*

1. What is the difference between offshoring and outsourcing? How does the concept of offshoring and/or outsourcing help illustrate the law of one price (especially with regards to labor)?

*Offshoring is production which takes place outside of the home country of the firm while outsourcing is production which takes place outside of the firm itself (but may or may not be within the home country).*

*Offshoring illustrates the law of one price since one really big reason firms offshore is to take advantage of cheap labor abroad. This puts upward pressure on foreign labor and downward pressure on domestic labor. This pressure should continue until (all other things being equal), the wages are identical.*

1. Why is judging the working conditions in developing countries by Western standards a deceptive approach, especially in the context of so-called sweatshops? In answering this question, be sure to explain why workers in developing countries would want to work under such harsh conditions.

*Protests against sweatshops tend to focus on the poor (by Western standards) working conditions. Yet good working conditions are expensive to provide: they can only be provided if a country/region is wealthy enough to provide it. As mentioned in the Stossel video, these “poor” working conditions are a step in the ladder to wealth.*

*“Step” is an important word, since these are some of the best conditions such workers have access to. The poor flock to sweatshops not because they are bad by Western standards (which is immaterial) but good by their opportunity cost (which is what really matters). The choice is not working in a sweatshop or working in an office but working in a sweatshop and working on a farm. Sweatshops are cleaner, safer, and more comfortable than their alternative.*

1. Consider the following information and, in each scenario, indicate which country’s currency—the US dollar or the Australian dollar—will appreciate. Justify your answer.
	1. US interest rates go up while the Australian interest rates stay the same.
	2. Thanks to Chinese demand for minerals, the mineral-rich and nearby Australian mining industry booms relative to the US’s.
	3. Next year, suppose forecasters believe the rate of inflation will be 3% in the US and 2% in Australia. Currently, assume both inflation rates are 1%.
	4. India develops a new breed of chicken which Australians find very tasty but Americans find disgusting.
2. *This would cause the US dollar to appreciate since more investors will want to park their money in the US where they earning a higher rate of return.*
3. *Australia’s exports is expected to increase, suggesting their dollar will become more valuable (it can buy more things); it will appreciate.*
4. *While the Australian dollar will buy less than it used it, the US dollar will be even worse off. Compared to the US dollar, the Australian dollar will appreciate.*
5. *Australians will start selling their dollar to get the Indian currency, putting more Aussy dollars on the global market. The American dollar will appreciate in comparison.*