Extra credit assignment, due on Wednesday, July 25
Answer the questions on this sheet or on another sheet of paper.

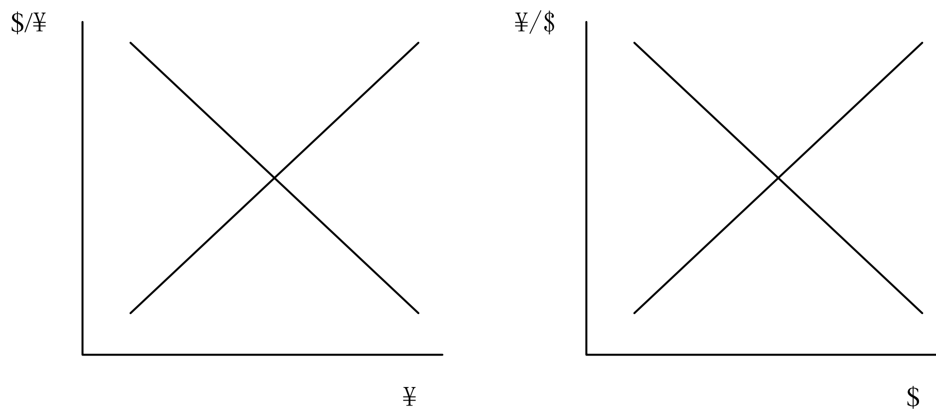
A model building exercise from Edward E. Leamer "A Flat World, a Level Playing Field, a Small World After All, or None of the Above? A Review of Thomas L. Friedman's The World is Flat" *Journal of Economic Literature,* Vol. XLV (March 2007) pp. 83-126.

"Imagine that there are two countries – Japan and the United States. Japan sits on the top of a hill and the United States sits at the bottom. To get U.S. goods to Japan, one has to hire porters to carry the goods up the hill. But the Japanese can put their products in a chute and let gravity do the work – costlessly transporting Japanese goods down the hill to the U.S. market. Not a level playing field, you should be thinking. Japan is clearly in the advantageous position. Not so fast, I caution the students. Who pays for lugging the U.S. products up the hill? Why do you presume it is the United States and not the Japanese? This should get them thinking about elasticities of supply and demand. If *U.S. goods are in short supply and are desperately desired by the Japanese*, while Japanese goods are abundant and not much desired by Americans, then it is the United States at the bottom of the hill that is in the advantageous position and it is the Japanese who pay for the lugging of the goods up the hill. If the Japanese build their mountain artificially with trade barriers that make it difficult to ship Washington apples to Japanese consumers and if the Japanese consumers would pay any price for those applies while Americans could care less about the latest Sony gadget, then it is the Japanese who pay for the barriers, not the Americans. So be careful when you put rocks in your harbor. And be sure to wear the right kind of glasses when you are viewing the playing field. What looks tilted one way with your regular glasses may be tilted the other way with econ-oculars." (p.89, emphasis added)

1.) Draw an import demand curve for Japan and an export supply curve for the U.S. such that, with transportation costs, Japanese consumers pay the majority of the transportation costs. Is the import demand curve elastic or inelastic? What does Leamer mean when he says, "…be careful when you put rocks in your harbor."?

The following is a quote from the 1998 book *Globaphobia: Confronting Fears about Open Trade*

> "…erecting new barriers to imports also has an unseen boomerang effect in depressing exports….While higher barriers to imports can temporarily improve the trade balance, this improvement would cause the value of the dollar on world exchange markets to rise, undercutting the competitive position of U.S. exports and curtailing job opportunities for Americans in export industries."



2a.) In the graph above, show which curves move when the U.S. erects trade barriers to Japanese imports. This is the two-country (U.S., Japan), two-currency (dollar, yen) model from lecture. Explain in the space below what is going on in the graphs above and how it relates to the argument above.

2b.) On the back of this paper, show a decrease in Japanese interest in investing in the U.S. economy. (Hint, Japanese investors need to change their yen into dollars before investing in the U.S. If they invest less, which curves will shift?)