Questions

Assume that the economy depicted below is Peru, a “small” economy. Assume that changes in the domestic quantity supplied or the domestic quantity demanded do not affect the world price. Not all correct answers are labeled on the graph. If the correct answer is not labeled, any reasonable estimate will be counted as correct.

1. Assume the world price for bicycles is $100. If trade is totally free, does Peru import bicycles or export them? How many bicycles does Peru import/export? What price do consumers in Peru pay for each bike?

2. Assume the world price for bicycles is $100. If a $100 tariff is imposed on each bicycle imported to Peru, how many bicycles will be produced in Peru? How much will consumers pay for each bike?

3. Assume the world price for bicycles is $100, and Peru imposes a quota of 100 bicycle imports per year. Does Peru import bicycles or export them? How many bicycles does Peru import/export? What price will consumers in Peru pay for each bike?

4. Assume the world price for bicycles is $100 and Peru offers a subsidy of $50 per bike to domestic producers. How many bicycles will be produced in Peru? How much will consumers in Peru pay for each bike?
Answer Key

1. Peru will import 170 bicycles and consumers in Peru will pay $100 for each.

2. About 200 bicycles will be produced in Peru and consumers will pay $200 for each.

3. Peru will import 100 bicycles and consumers in Peru will pay about $130 (between 110 and 190 would be acceptable).

4. Peru will produce 150 bicycles and consumers in Peru will pay $100 for each.