NAME: _____

Student ID No.: _____

Economics 340
International Economics
Prof. Alan Deardorff
First Midterm Exam

Form (KEY) 0

Answers

October 21, 2019

INSTRUCTIONS: READ CAREFULLY!!!

1. Please do not open the exam until you are told to do so.

2. **PLACE YOUR NAME AND STUDENT ID NO. (THE <u>EIGHT</u> DIGIT NUMBER FROM YOUR M-CARD) ON THE EXAM <u>AND</u> ON THE SCANTRON SHEET.**

3. Find the **FORM NUMBER** above and enter it where it asks for "KEY" on the scantron sheet. Be sure to fill in the bubbles.

4. This exam has 100 points and you have approximately 80 minutes to complete the test. Check that you have all 16 pages of the exam, including this cover sheet.

5. **Part 1** consists of 25 multiple choice questions worth 2 points each. Answers to these should be marked on the scantron sheet using a #2 pencil. There are no penalties for guessing.

6. **Part 2** consists of short-answer questions for which you must provide written answers on these sheets. Point values for questions in Part 2 are indicated in parentheses. Part 2 has 48 points total.

7. That leaves 2 points unaccounted for. You will get these if (and only if) you put your name and ID number on both this exam booklet and the scantron sheet, **and** if you enter the form number (see above) on the scantron.

8. Good luck!

FORM 0

Economics 340
First Midterm Exam

Part 1: Multiple Choice (2 points each)

Select the **best** answer of those given. Answers to this part should be marked on the scantron sheet using a #2 pencil. There is only one correct answer per question, and there is no penalty for guessing.

1.   Which of the following statements about losses from trade or trade policy is correct?

   a.   The United States has lost from trade during the last fifty years, because its exports have risen more slowly than its GDP.
   b.   Poor countries are hurt by the structure of developed country tariffs, which are lowest on processed goods that developing countries are unable to produce.
   c.   Poor countries lose more than rich countries from the tariffs that exist today, because tariffs on their exports are higher than on developed-country exports.
   d.   NAFTA hurt the Mexican manufacturing sector at the same time that it benefited Mexican farmers.
   e.   The United States has little to gain from trade liberalization by developing countries, because only a negligible portion of US exports go to them.

   Ans: *c*

2.   How has the total volume of world trade performed over the last ten years or so?

   a.   It has consistently grown faster than world GDP.
   b.   It fell dramatically during the world recession of 2008-9, but recovered and has resumed its rapid growth ever since.
   c.   It has grown faster in advanced nations than in emerging nations.
   d.   After a large drop during the world recession, it recovered and resumed slower growth with occasional slowdowns.
   e.   It has never risen to the level reached before the world recession.

   Ans: *d*

3. What is a Rule of Origin?

    a. A prohibition on employing illegal immigrants.
    b. A requirement for registering to vote.
    c. A restriction on who can invest in a country.
    d. A specification of what qualifies for zero tariff.
    e. A law against exporting imitations.

    Ans: d

4. Which of the following was **not** subject to increased import tariffs by the United States during 2018-2019?

    a. Automobiles from Japan.
    b. Steel from Europe.
    c. Many goods from China.
    d. Washing machines from South Korea.
    e. Solar panels from Vietnam.

    Ans: a

5. Which of the following is **not** one of the ways the President Trump can undermine the World Trade Organization?

    a. By negotiating a free trade agreement with Canada and Mexico.
    b. By preventing appointment of new judges on Appellate Body.
    c. By claiming decisions are invalid.
    d. By not engaging in WTO negotiations.
    e. By ignoring its rules.

    Ans: a

6. In class we saw an example of a Ricardian model in which one country (we called it UK' - United Klutzes) was less productive in both sectors than the country with which it would trade. As a result, the wage in UK' fell from $10 in autarky to $1.50 with free trade. Nonetheless, workers in UK' were better off with trade than without because

    a. The wage in the other country fell even more.
    b. The UK' wage rose in terms of the good it imported.
    c. The UK' wage rose in terms of the good it exported.
    d. Workers worked more hours per week.
    e. Workers worked fewer hours per week.

    Ans: b

7. The theory of comparative advantage is hard to test in the real world because?

    a. Costs of what is being produced are impossible to observe.
    b. Wages differ across countries.
    c. The theory holds only with free trade, but most countries have tariffs.
    d. The theory assumes there are only two goods and two countries, but in fact there are more of both.
    e. Comparative advantage is defined in terms of autarky prices.

    Ans: e

8. In class we saw several explanations for intra-industry trade. Which of the following is **not** one of them?

    a. Products in the same industry are differentiated by brand or style.
    b. Firms with market power selling identical products sell into each other's markets.
    c. With long borders between countries, the same good may be exported across one part of the border and simultaneously imported across another.
    d. Firms first export and then import the same good in order to add to its cost and thus increase the profit they can earn by selling it.
    e. Data on trade sometimes lump together inputs to an industry (e.g., parts) with outputs.

    Ans: d

9. Factor Price Equalization means that,

    a. All workers are equally productive.
    b. If a country fails to trade, its skilled workers will earn no more than its unskilled
        workers.
    c. Trade causes the return to human capital to be the same as the return to physical
        capital.
    d. For countries to trade freely, they must tax factors of production so that firms in
        all countries pay the same factor prices.
    e. Free trade causes identical factors in different countries to be paid more nearly
        the same than they were in autarky.

        Ans: e

10. The figure shows the effects of a tariff in a small country. The area of the shaded
    triangle represents

    a. The amount by which domestic
        producers' total costs rise.
    b. The portion of dead weight loss due to the
        change in supply.
    c. The increase in revenue of suppliers.
    d. The tariff revenue of the government.
    e. All of the loss to demanders that is not a
        benefit to anyone else.

        Ans: b
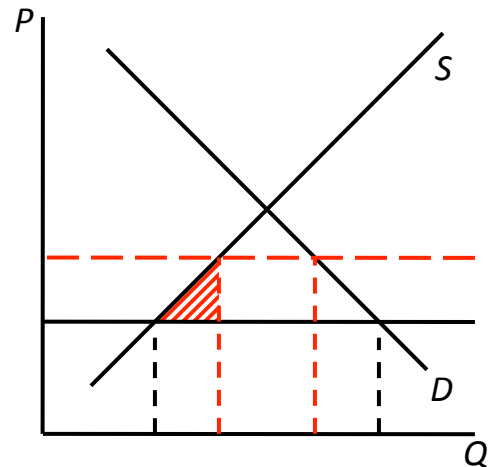
11. Based on our supply-and-demand model of a
    tariff, if a large country uses a tariff that is so
    high that it reduces the quantity of imports to zero, then

    a. The country's welfare falls.
    b. The country's welfare may rise or fall, depending on whether the world price
        rises or falls.
    c. The country's welfare must rise, if the world price falls.
    d. The country's welfare rises only if its output of the good expands.
    e. The effect on the country's welfare cannot be determined, since it depends on
        how foreign suppliers respond.

        Ans: a

12. Suppose that the tariff on shirts is 20% while the tariff on the cloth used to make the shirts is also 20% and there is no tariff on any of the inputs needed to produce cloth. The tariff on cloth is now reduced from 20% to 10%, while the tariff on shirts remains 20%. Which of the following, if any, is **not** true? (Answer e if all of a-d **are** true.)

    a.   The nominal rate of protection on cloth is reduced.
    b.   The effective rate of protection on cloth is reduced.
    c.   The nominal rate of protection on shirts is unchanged.
    d.   The effective rate of protection on shirts is unchanged.
    e.   None. That is, all of the above are true.

    Ans: *d*

13. A variable levy is

    a.   A tax on imports that is low for small imports and high for large imports.
    b.   A commitment by a foreign country to reduce its exports.
    c.   An import quota the size of which is changed from month to month.
    d.   A tax that rises with the value of imports.
    e.   A tariff that is changed as necessary to keep domestic price at a specified level.

    Ans: *e*

14. A government procurement regulation or practice constitutes a nontariff barrier when

    a.   Government agencies are required to purchase from the lowest bidder.
    b.   Government requires that goods that it purchases meet a uniform safety standard.
    c.   Government purchases are financed by tax receipts.
    d.   Government shows a preference for domestic sellers over foreign sellers.
    e.   Government-owned enterprises are not required to make a profit on inputs that they purchase at home or abroad.

    Ans: *d*

15. Why do governments so often choose to protect favored industries with tariffs?

   a. The economic benefits to the industries are larger than the costs to demanders.
   b. The economic benefits to the industries are larger than the cost to government.
   c. The few who gain from protection each gain a lot, while the many who lose each lose only a little.
   d. The gains from protection are enjoyed by many, while the costs are borne by only a few.
   e. They don't; most protection is provided by quotas, not tariffs.

   Ans: *c*

16. The "political economy" model for explaining tariffs assumes that

   a. Politicians care only about campaign contributions in setting tariffs.
   b. Tariffs are set so as to benefit the largest number of voters.
   c. Tariffs are used to influence political outcomes in other countries.
   d. Politicians try to strike a balance between the well-being of the economy and their own prospects for being elected.
   e. Members of Congress seek tariffs to protect their own constituents, and they agree in exchange to support the same for other members.

   Ans: *d*

17. Since 2002, the United States has had a program of Alternative Trade Adjustment Assistance, which

   a. Pays certain workers a fraction of their drop in wage if they take a lower paying job after being displaced by trade.
   b. Helps firms to redirect their exports and/or imports when they have been disrupted by a trade embargo.
   c. Compensates exporters for the increase in their costs caused by exchange rate changes.
   d. Provides extended unemployment compensation to workers who have lost their jobs due to competition from imports.
   e. Is a computerized system for filling out customs declarations at the border.

   Ans: *a*

18. The International Trade Administration

    a. Sets import tariffs in the United States.
    b. Decides if imports have been dumped.
    c. Is a United Nations agency that oversees the uses of tariffs and quotas by its member countries.
    d. Subsidizes exports of agricultural products.
    e. Negotiates trade agreements between the US and other countries.

    Ans: *b*

19. Regarding the GSP, Glassman argues that it is "illogical" because

    a. It grants tariff preferences to rich countries.
    b. It violates MFN.
    c. The US cannot afford to lose tariff revenue from the government budget.
    d. It hurts the countries that it is supposed to help.
    e. It benefits countries that oppose the US in trade negotiations.

    Ans: *e*

20. The Swiss Formula is $Z = AX/(A+X)$. This formula has been used

    a. In tariff negotiations to reduce high tariffs more than low tariffs.
    b. By the USITC to define an acceptable margin of dumping.
    c. To measure the extent to which the value of imports exceeds the value of exports due to transportation costs.
    d. To define the tariff level that is set by a variable levy.
    e. To calculate the preferences demanded of Switzerland in order for it to join the European Union.

    Ans: *a*

21. If a member country of the World Trade Organization violates one of its rules and persists in doing so after losing a dispute settlement case, the ultimate remedy provided for in the rules of the WTO is

    a. Nothing. The WTO has no punishment for breaking its rules.
    b. A monetary fine, levied by the WTO and collected by the International Monetary Fund.
    c. The use of increased import tariffs by other countries on the offending country's exports.
    d. The requirement that the offending country reduce all of its tariffs to zero.
    e. Confiscation of the assets of the country that broke the rules.

    Ans: *c*

22. Immigration into the United States has kept the US population younger, on average, than the population of Japan, where much less immigration occurs. When we speak of the demographic effects of immigration, we observe that

    a. This helps Japan, because their workers have more experience.
    b. This helps the US, because more young workers are available to support the elderly.
    c. This hurts Japan, because their older workers are physically weaker and therefore less productive.
    d. This hurts the US, because the immigrants are lazy.
    e. Both the US and Japan gain from this exchange, as the immigrants send remittances to their families in Japan

    Ans: *b*

23. When one author on the subject of US immigration complains that "balkanization has replaced assimilation," he means that

    a. Today's immigrants come increasingly from South Eastern Europe.
    b. Today's immigrants live in enclaves with others like themselves, instead of intermingling with the larger population.
    c. Immigrants take more from social services than they give back.
    d. Restrictions on immigration are preventing qualified workers from entering the United States and filling jobs, which therefore go unfilled.
    e. Immigrants are now being admitted from only a handful of isolated places around the world, in contrast to drawing from the whole world as we used to do.

Ans: *b*

24. What did the WTO most recently (in the news we reported) rule regarding the dispute between the US and EU on the trade of airplanes made by Boeing and Airbus?

   a. That US tariffs on imports of Airbus planes are illegal.
   b. That the EU was continuing to subsidize Airbus.
   c. That the US was continuing to subsidize Boeing.
   d. That the EU should be permitted to impose tariffs on US exports.
   e. That the US should be permitted to impose tariffs on EU exports.

   Ans: *e*

25. Since the start of the trade war, whose currency has increased in value most relative to others?

   a. China's
   b. Japan's
   c. Europe's (the euro)
   d. The US's
   e. None; exchange rates are fixed by international agreement.

   Ans: *d*

Part II: Short Answer

Answer on these sheets in the space provided.

1. (5 points) What do the following acronyms stand for in international economics, and/or what do they mean?

   a. IMF

   b. UPU

   c. TRQ

   d. WIPO

   e. IIT

2. (3 Points) The graph below appeared in the first lecture, showing how the following three economic variables for the world changed over the period 1990-2010. Identify which curve is which by writing a, b, or c in each of the boxes.

   a. Average tariff applied
   b. World trade volume
   c. World GDP

Sources: World Bank; IMF   *Forecast
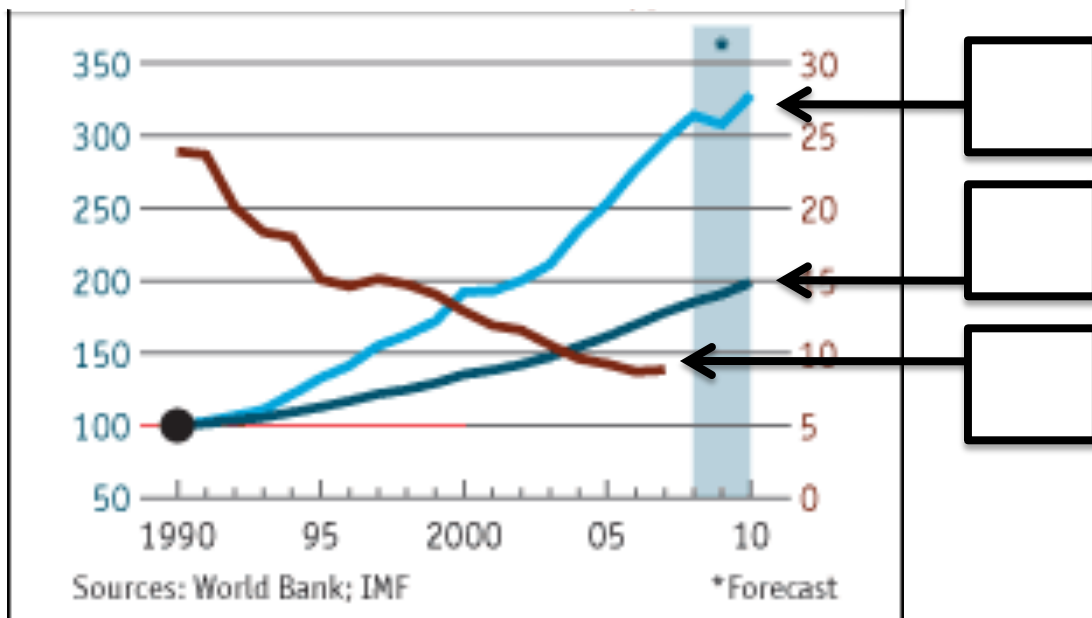
3. (8 points) Each of the first three tables below shows the amounts of labor required to produce one unit of each of two goods, X and Y, in two countries, A and B. These are the only goods, and the only countries, in the world. In each case, fill in the blanks with "X," "Y," "A," "B," "both," or "neither."

a. Country A has absolute advantage in good *neither*

Country B has comparative advantage in good *X*

Labor needed per unit of output

Good	Country A	B
X	30	20
Y	1.6	1.2

b. Country with absolute advantage in good X: *B*

Country with comparative advantage in good Y: *A*

Labor needed per unit of output

Good	Country A	B
X	330	310
Y	9800	9800

c. Country that exports good X: *A*

Country that exports good Y: *B*

Labor needed per unit of output

Good	Country A	B
X	0.01	0.02
Y	0.03	0.04

The table below looks much like the ones above, but this one gives a different kind of information: output per worker (productivity). Fill in the blanks as above.

d. Country that exports good X: *A*

Country that exports good Y: *B*

Output produced per unit of labor

Good	Country A	B
X	200	190
Y	0.8	0.8

4. (5 points) Indicate, by circling the correct answer, what the Heckscher-Ohlin model predicts about the changes that will occur when a country opens up to international trade.

    a. Production of its export good will:

        increase   decrease   stay the same

    b. Production of its import-competing good will:

        increase   decrease   stay the same

    c. Demand for the country's abundant factor (at initial factor prices) will

        increase   decrease   stay the same

    d. The price of the scarce factor will

        rise   fall   stay the same

    e. The price of the abundant factor will

        rise   fall   stay the same

5. (2 points) In the space below, state two of the implications of the New Trade Theory, *with regard to gains or losses from trade*, that are different from the Heckscher-Ohlin model.

    Answer: Any two of:
    I.   *Countries may lose from trade.*
    II. *All factors may gain from trade.*
    III. *Countries may gain by exploiting increasing returns to scale.*
    IV. *Countries may gain from trade causing greater competition.*
    V.   *Countries may gain by providing consumers an increased variety of differentiated products.*

6. (10 points) The graphs below show supply and demand curves for the same good in
    two countries, A and B, together with labeled grids from which you can read prices
    and quantities. Follow the instructions below by adding the requested information to
    the graphs and filling in the blanks with the requested numbers or symbols.
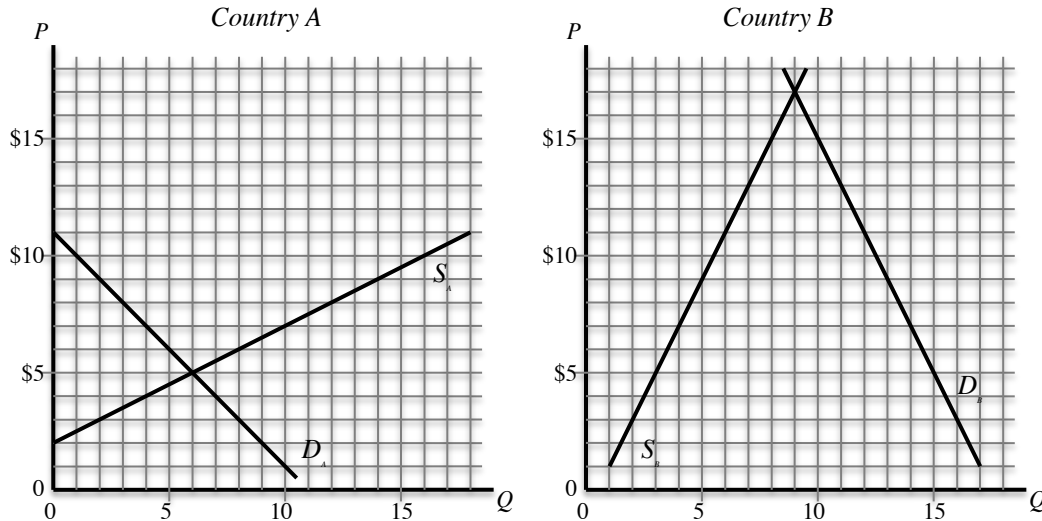
a.   In each country, draw a horizontal line at the autarky price, and label the autarky
     prices P_A and P_B.

b.   What quantity of the good is supplied in autarky in Country A?   6

     What quantity of the good is demanded in autarky in Country B?   9

c.   Find the equilibrium world price when these two countries are opened to free trade
     with each other. Draw a horizontal line at that price across both graphs and label it
     P_W.

d.   Add labels "a", "b", "c", etc. to areas formed by the lines in the figure as needed,
     and use them to identify the following effects on welfare in the two countries due to
     the move from autarky to free trade. Be sure to include the signs, "+" or "–" for
     each.

     The gain (+) or loss (–) to suppliers in Country A: +(a+b)

     The gain (+) or loss (–) to demanders in Country B: +(c+d)

     The net gain or loss to Country B as a whole: +d

e.   Using the grid, find the dollar value of Country A's net gain or
     loss from trade.   +$13.5

f.   Which of these countries gains more from trade, if any (say "A,"
     "B," or "neither")?   B

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7. (9 points) The figure at the right shows domestic supply and demand for a good in a small country, together with several prices and quantities labeled on the axes. Initially, with free trade, the country faces a world price equal to P_1. Using the prices and quantities, as well as the areas labeled in the figure as appropriate, answer the following.
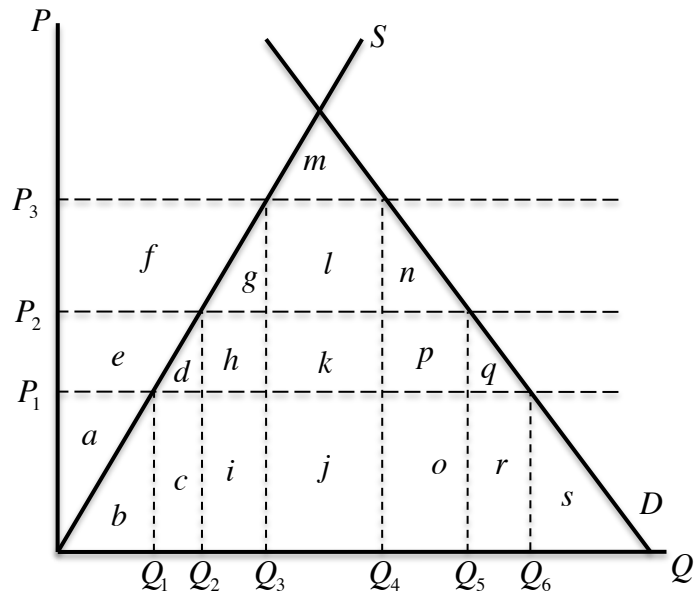
a. What is the quantity of imports with free trade at the world price P_1?

Quantity of imports = <u> Q_6–Q_1 </u>

b. Suppose the country now limits imports with a quota that raises domestic price to P_3 (ignore P_2 for now). What is the size of the quota, how much are the quota rents, and what size *ad valorem* tariff, t, would have done the same?

Quota = <u> Q_4–Q_3 </u>   Quota rents = <u> *Area k+l* </u> t = <u> $(P_3$–$P_1)/P_1$ </u>

c. How much do domestic suppliers gain or lose (compared to free trade) as a result of this quota?

Welfare change of domestic suppliers = <u>   *Gain of area e+f*   </u>

d. Suppose now that the world price rises from P_1 to P_2 in the figure. Record below, by circling the correct answer, the effects of this rise in world price in the presence of this (unchanged) quota:

The tariff equivalent (t)	rises	falls	stays the same
Domestic suppliers	gain	lose	are unaffected
Domestic demanders	gain	lose	are unaffected

e. Suppose instead that the world price remains at P_1 and that the quota itself is changed so that the domestic price falls to P_2. If the rights to import are given away to foreigners, before and after this change, in what direction and by how much does the country's net welfare change as a result of this change

Net welfare change of country = <u>   *Gain of area (g+l+n)*   </u>

8. (6 points) Define the following terms as they are used in international economics:

a. Import license
Ans: A permit to import a specified quantity of a good that is subject to an import quota.

b. Safeguards
Ans: A policy that provides temporary protection when an industry has been injured by imports.

c. Specific tariff
Ans: A tariff that is defined as an amount of currency per unit of the good.

d. Smoot-Hawley tariff
Ans: The large increase in US tariffs on hundreds of goods that was implemented at the beginning of the Great Depression.

e. Dead-weight loss
Ans: The portion of lost consumer surplus that is not a gain to anyone else (producers or the taxpayer); thus the net economic loss to the country as a whole.

f. Dumping
Ans: Export of a good at a price below the "fair" price, the latter defined either as cost, or as the price on the home market.