

Name \_\_\_\_\_

UMID \_\_\_\_\_

**Final Exam**  
**April 26, 2018**  
*Answers*

Answer on these sheets. Note that the last page of the exam (page 10) is intentionally left blank for you to use if you run out of space to answer any of the questions, although I do not intend that you should necessarily need it.

The exam has a total of 90 points.

1. (30 pts.) Explain any fifteen (15) of the following eighteen institutions, concepts, or policies. (If you answer more than 15, I will grade only the first 15, so be sure to cross out any answers you don't want me to grade.)
  - a) Appellate Body: *The standing committee of the World Trade Organization that handles appeals by countries of the reports issued by WTO Dispute panels.*
  - b) KORUS: *The Free Trade Agreement between the United States and South Korea, negotiations between which to amend the agreement have just been completed.*
  - c) Section 301: *The part of US trade law that permits the US to take action against unfair trade policy actions by other countries, including in US export markets.*
  - d) Effective rate of protection: *A measure of the protection provided by the structure of tariffs, on both outputs and inputs, to an industry. Tariffs on inputs provide negative protection that may, if the imports are a large part of cost, cause effective protection to be negative.*
  - e) The United States Export-Import Bank: *A U.S. government agency that guarantees loans to, and provides credit insurance for, foreign buyers of U.S. exports.*
  - f) Contingency measures: *A collective term for anti-dumping duties, countervailing duties, and safeguards tariffs. (per WTO, "Trade Policy Review: Japan")*

- g) Product upgrading: *China's the tendency of exporting firms, when constrained by an import quota for VER, to improve the quality of, and add extra features to, the product that they export so as to sell its limited quantity for a higher price. (per Feenstra)*
- h) Tariffication: *The conversion of quantitative non-tariff barriers into numerical tariffs, done during the Uruguay round in order to put them in a form that would later be easier to negotiate downward. (per Beattie)*
- i) Vertical link: *An input-output linkage between industries, such as the use of steel by the auto industry, so that a tariff on steel raises the cost of producing autos, and a tariff on autos may increase the demand for steel. (discussed with Fetzer)*
- j) Median voter theory: *The theory of politics that, with a democratic majority vote on a single issue, it is the opinion of the median voter that decides the outcome. (per KOM Ch. 10).*
- k) Customs union: *A pair or group of countries that reduce to zero most of their tariffs on each other and agree to levy common tariffs on goods from outside the group.*
- l) Sensitive sector: *A sector of an economy that is viewed as most vulnerable to competition from imports within a proposed FTA and is therefore exempted from its tariff cuts. (per Deardorff)*

- m) ISDS: *Investor-State Dispute Settlement: a provision of an FTA investment agreement that creates a special international tribunal or other mechanism to adjudicate disputes between multinational firms and government other than their own. (per Deardorff)*
- n) Negative list: *A list of activities or products that a provision of an agreement (such as a trade agreement) will **not** apply to, with the implication that the provision **does** apply to any activities or products not listed, including new ones that may not have existed prior to the agreement. (per AFL-CIO, NAFTA at 20)*
- o) Stolper-Samuelson Theorem: *The implication of the Heckscher-Ohlin trade model for the real prices of factors. One version is that abundant factors gain from trade and scarce factors lose.*
- p) Chapter 19 of NAFTA: *The portion of NAFTA that creates a special tribunal to which the member countries can appeal the anti-dumping actions of other member countries. (per Panetta)*
- q) Lesser-duty rule: *The EU policy that anti-dumping duties should be set at the level of the smaller of the dumping margin and the injury margin. (per Jackson Ch 10; also Jakob)*
- r) Predatory dumping: *Dumping intended to drive out all competitors with the intent of then raising price to the monopoly level. (per Deardorff)*

2. (18 pts.) True or False (circle one)

- a. The Gravity Model explains trade between rich and poor countries based on the differences in their per capita incomes.

True                  False                  *Ans: False (per KOM)*

- b. The next country to join the European union is most likely to be Turkey.

True                  False                  *Ans: False (per Pop & Peker)*

- c. China is Canada's second largest trading partner, after the United States.

True                  False                  *Ans: True (per Vieira)*

- d. The exit of the United States from the Trans-Pacific Partnership did not prevent the TPP from going into effect, since it only required that eleven of the twelve countries ratify it, and they did.

True                  False                  *Ans: False (per Economist 11/16/17)*

- e. In the Brexit vote, those who voted to "leave" won, even though the "remain" side raised more money.

True                  False                  *Ans: True (per Wheeler & Hunt)*

- f. An import quota, if allocated to foreigners, can benefit a country only if it is large enough to change the world price of the imported good.

True                  False                  *Ans: False (such a quota is even worse if the country is large)*

- g. In order to get safeguard protection, an industry must show a greater level of injury from imports than would be required to get a countervailing duty.

True                  False                  *Ans: True*

- h. In the European Union, dumped imports may not be subjected to an anti-dumping duty, even if they cause injury, if they are "against the community interest."

True                  False                  *Ans: True (per EC, DG-Trade, "Anti-dumping")*

- i. A “variable levy” does not violate GATT/WTO rules as long as the country using it has not “bound” the level of the tariff for the protected industry.
- True                  False                  *Ans: True (per Jackson Ch. 5)*
- j. If a country imports a good that is not a perfect substitute for anything that is produced within the country, then there is no reason for it to levy a tariff on it.
- True                  False                  *Ans: False (producers of imperfect substitutes will benefit)*
- k. Prior to joining the World Trade Organization in 2001, China’s exports to the U.S. were not subject to its MFN tariffs, but to the higher ones that it had erected in the 1930s.
- True                  False                  *Ans: False (per Baldwin & Magee. China got MFN status in the US in 1980 under Carter, but it was subject to renewal yearly until China joined the WTO.)*
- l. An export subsidy, if not accompanied by an import tariff, will stimulate imports.
- True                  False                  *Ans: True*
- m. Wage insurance is another name for unemployment insurance.
- True                  False                  *Ans: False*
- n. During his campaign to become US President, Barak Obama spoke in favor of renegotiating NAFTA.
- True                  False                  *Ans: True (per Faux)*
- o. Manufacturing’s share of US employment fell faster after NAFTA than before.
- True                  False                  *Ans: False (per DeLong)*
- p. In the Ricardian Model of international trade between two countries of unequal size, the larger of the two countries that may not gain from trade.
- True                  False                  *Ans: True*

- q. The theory of comparative advantage is impossible to test, because autarky prices have never been observed.

True

False

*Ans: False (per Bernhofen & Brown)*

- r. If two countries open to trade in an industry with external economies of scale, price will rise in the initially low-price country and fall in the high-price country.

True

False

*Ans: False (prices fall in both)*

3. (6 pts.) In the monopolistic competition model of the text, what happens when two previously closed identical economies open to free trade? Circle the appropriate answers below.

a) Number of firms in the world	Rises	Falls	Stays the same	<i>Falls</i>
b) Number of varieties available to consumers	Rises	Falls	Stays the same	<i>Rises</i>
c) Price of each good	Rises	Falls	Stays the same	<i>Falls</i>
d) Average cost of each good	Rises	Falls	Stays the same	<i>Falls</i>
e) Output per firm	Rises	Falls	Stays the same	<i>Rises</i>
f) Profit per firm	Rises	Falls	Stays the same	<i>Same</i>

4. (15 points) The graph below is taken directly from the slides for the class on Subsidies, where we looked at a domestic subsidy paid by the government of Country A per unit of output. Country A is importing the good in the initial equilibrium at price  $P_0$ . Here I'd like you to analyze instead a similar subsidy paid per unit of output produced in the exporting country, Country B, instead. The size of the subsidy,  $s$ , is shown at the bottom of the vertical axis for Country B.

a) In the right panel, draw the domestic supply curve in Country B in the presence of the subsidy, then construct the new export supply curve of Country B in the middle panel.

b) From that, find the new equilibrium price in all three panels, and label it  $P_1$ .

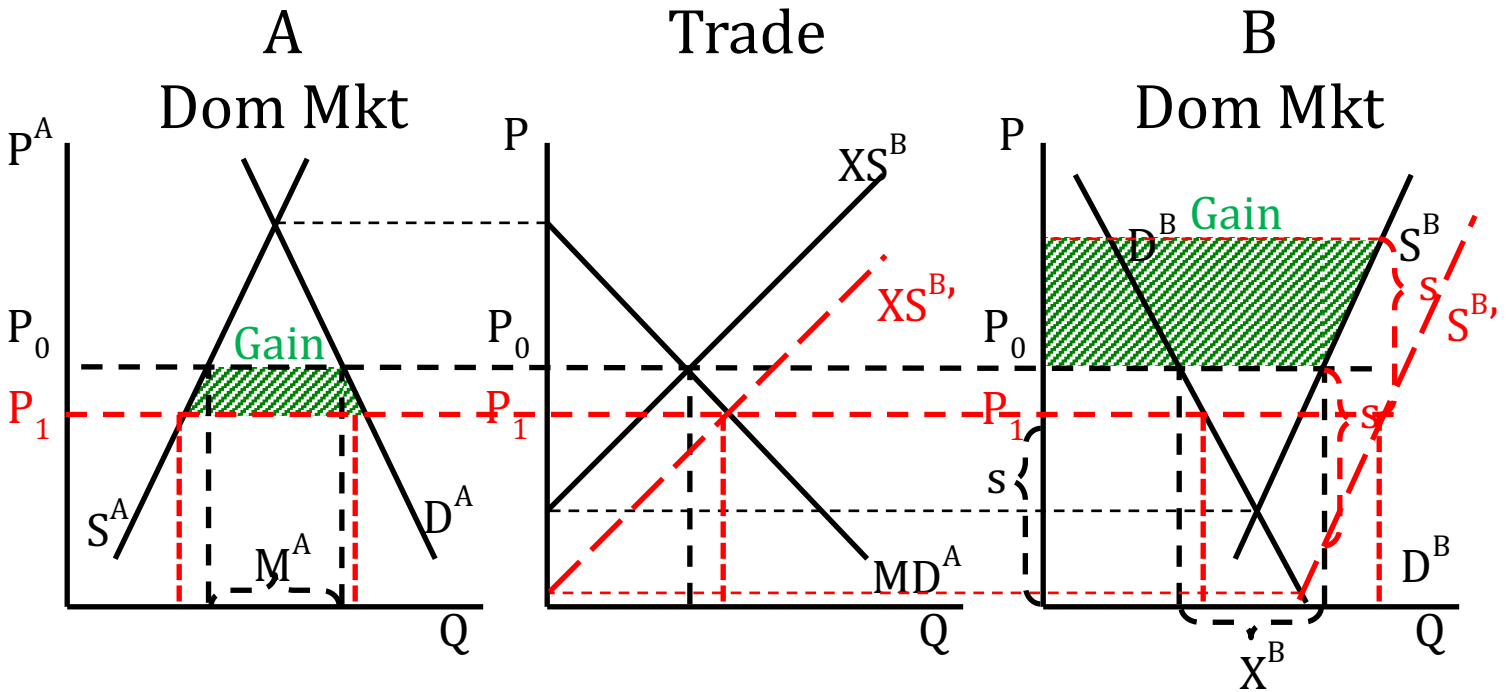
c) Based on the price change that you found in part (b),

i. circle the directions of change of the quantities supplied, demanded, and traded by each country:

$S^A$	+	$D^A$	+	$S^B$	+	$D^B$	+	$M^A$	+	$X^B$	+
-------	---	-------	---	-------	---	-------	---	-------	---	-------	---

ii. Shade in for Country A the net gain or loss of its welfare and write "gain" or "loss" next to it.

iii. Shade in for Country B the change in producer surplus and write "gain" or "loss" next to it.

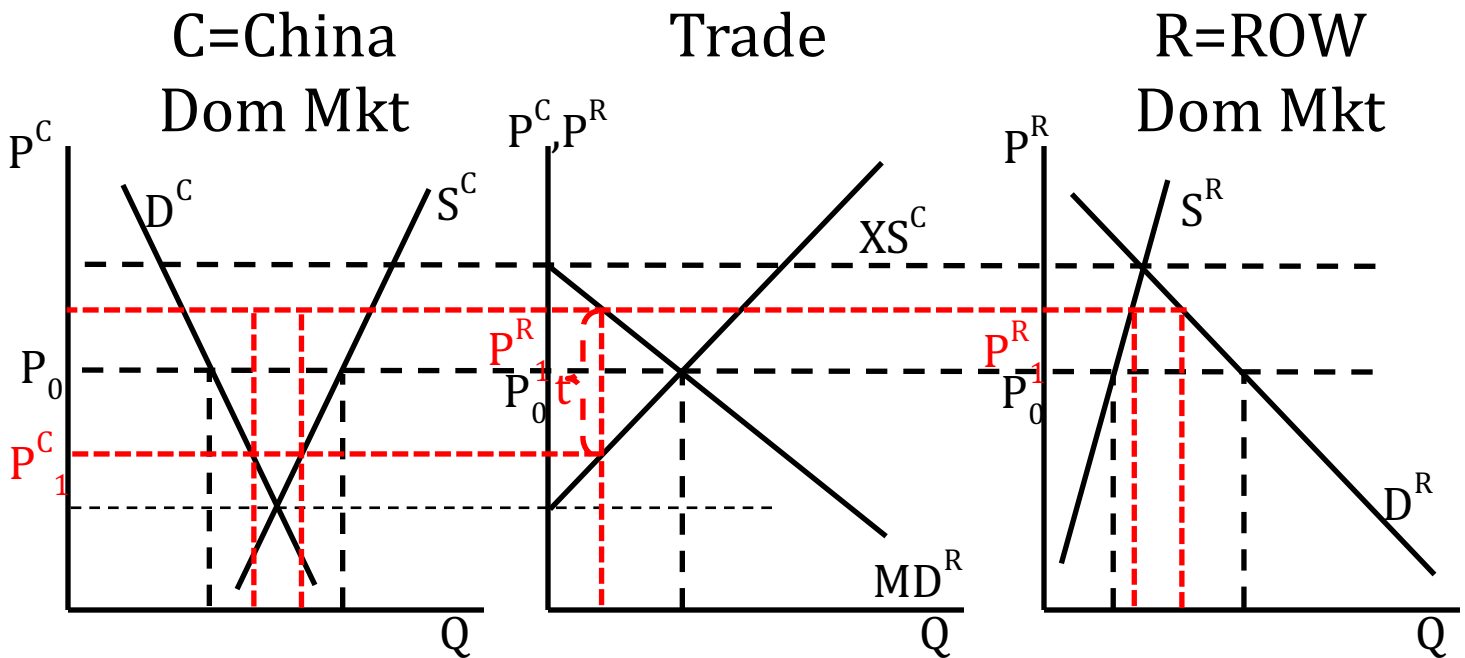


d) Without doing any further formal analysis, state here whether you expect Country B as a whole to gain or lose from this production subsidy, and why.

Ans: Country B loses from this subsidy, as it not only distorts its markets but it also, since the world price of its export falls, worsens its terms of trade.

5. (21 pts.) Early in the course, in an article by Mauldin, we saw that China was taxing exports of raw minerals of which China is the world's major producer. Write a short essay including the following:
- (5 pts.) What effects this tax would have on the prices of these minerals, both in China and in the rest of the world.
  - (8 pts.) Illustrate your argument with an appropriate diagram or diagrams.
  - (4 pts.) Explain on what basis the US is able to complain about this action to the WTO.
  - (4 pts.) Why China may want to cause the effects that you identified in part (a).

*Ans: (a) As illustrated below, China initially exports the good to the rest of world, R, at the price  $P^0$ , which is also the domestic price both in China and abroad. China's export tax,  $t$ , then drives a wedge, in the market for trade, between the higher price,  $P_1^R$ , paid by foreign importers and the lower price,  $P_1^C$ , paid by China's demanders and received by Chinese suppliers.*



*(c) As explained by Mauldin, the WTO does not in general prohibit export taxes, so if this were any other country than China, the U.S. would not have a valid complaint at the WTO. However, China's accession agreement to the WTO included a commitment not to tax exports, and it is on this basis that the U.S. brings its complaint.*

*(d) China says that it is taxing these exports because their mining in China is bad for the environment. But a more likely reason is that, as these price effects suggest, the tax makes the minerals cheaper for China's high-tech industries that use the minerals as inputs, while making them more expensive for those industries that compete with China abroad.*

[This page intentionally left blank for your use if needed.]