

Study Questions
(*with Answers*)

Lecture 18
Preferential Trading Arrangements

Part 1: Multiple Choice

Select the **best** answer of those given.

1. Which of the following is **not** a preferential trading arrangement?
 - a. EU
 - b. NAFTA
 - c. OECD
 - d. GSP
 - e. Anti-dumping duty

Ans: c

2. Which of the following explains why **trade diversion** is undesirable for an importing country that lowers its tariff against a partner in a free trade area?
 - a. The country imports from the partner at higher cost than it previously imported from some other country.
 - b. Domestic producers suffer a loss of income.
 - c. Workers are laid off as producers shift production into the partner country.
 - d. Consumers pay a higher price for the good imported from the partner.
 - e. All of the above.

Ans: a

3. When a country eliminates its tariff against a partner country, keeping the tariff positive against other countries, the effect of that change alone is that the partner country as a whole
- Must gain.
 - May either gain or lose.
 - Will neither gain nor lose.
 - Must lose.
 - None of the above; it depends on whether there is trade creation or trade diversion.

Ans: a

4. Because wages in Mexico before the NAFTA were only a small fraction (perhaps 1/10) of wages in the U.S., we should infer that
- Prior to NAFTA, Mexican workers were paid far below their productivity.
 - After NAFTA, most U.S. firms would be unable to compete with imports from Mexico.
 - After NAFTA, most U.S. firms would close their U.S. plants and move to Mexico.
 - Prior to NAFTA, since U.S. tariffs against Mexico were small, the productivity of Mexican workers must also have been only a small fraction of that in the U.S.
 - After NAFTA, forcing Mexican workers to compete with more productive U.S. workers would drive their wages even lower.

Ans: d

5. Why did NAFTA not have a significant effect on US unemployment?
- No jobs were lost in the US due to NAFTA.
 - The number of workers who lost jobs due to NAFTA was a tiny fraction of normal US labor turnover.
 - Workers who lost jobs in the US were able to move to Mexico.
 - The US reneged on its NAFTA promise to lower tariffs on imports from Mexico.
 - Mexican companies built factories in the US that employed US workers that had been laid off from US factories.

Ans: b (See DeLong)

6. How has the US share of employment in manufacturing changed before and after NAFTA?
- a. It rose before NAFTA and fell after.
 - b. It fell before NAFTA and rose after.
 - c. It rose both before NAFTA and after.
 - d. It fell both before NAFTA and after.
 - e. It was constant over time before NAFTA and fell after.

Ans: d (See Schultz and Aspe)

7. Why did the NAFTA not require free trade within North America in energy?
- a. Because the NAFTA countries did not then produce energy products.
 - b. Because Ross Perot, an oil company executive, would have objected.
 - c. Because that would have violated the rules of the GATT.
 - d. Because Republicans owned the US oil companies.
 - e. Because the oil sector in Mexico at that time was state owned.

Ans: e (See Schultz and Aspe)

8. Once the USMCA is in place, how much of a car imported into the US from Mexico with zero tariff can be imported from China?
- a. None
 - b. 10%
 - c. 25%
 - d. 37.5%
 - e. 50%

Ans: c (The required North American content rises to 75% from the 62.5% required in NAFTA)

Part II: Short Answer

Answer in the space provided.

1. For each of the types of preferential arrangement named across the top of the following table, indicate with a check mark below it whether it has the properties indicated:

	Free Trade Area	Customs Union	Common Market

Higher tariffs against non-members than against members	✓	✓	✓
Zero tariffs against members	✓	✓	✓
Common external tariff		✓	✓
Free movement of labor among members			✓

2. Fill in the blanks:

- a. During the 2008 Democratic primary campaign, candidates _____ and _____ argued for renegotiating NAFTA. *Ans: Obama; Clinton*

- b. During the 2016 US presidential campaign, which of the candidates, Trump and/or Clinton, argued for renegotiating NAFTA? _____ *Ans: Trump*

- c. In the USMCA, autos will be imported from Mexico to the US duty-free only if over 40% of their value was added by workers making over _____ per hour. _____ *Ans: \$16*

- d. The USMCA requires that members must inform the others 3 months prior to beginning trade negotiations with _____. *Ans: Any non-market economy (but they really mean China).*

3. Circle the appropriate word in the sentence below, and then write an explanation in the space below that.

An RTA is An example of
 A violation of MFN.
 Unrelated to

Ans: An RTA is a regional trade agreement, in which members charge lower tariffs (usually zero) on imports from other parties to the agreement than they charge on imports from outside the group. MFN stands for Most Favored Nation, and refers to the principle of the GATT and WTO that countries will give all countries the same treatment that they give the most favored nation, meaning that they would not charge different tariffs against imports from different countries. Thus an RTA is a violation of MFN.

4. Define or explain:

- a. Trade creation

The replacement of purchases from domestic producers by purchases from producers in the partner country of a preferential trading arrangement that occurs when tariffs are reduced on imports from the partner.

- b. Mercosur

The customs union of Brazil, Argentina, Uruguay, Paraguay, and Venezuela

- c. Fund for investment in Mexico

In the reading by Faux, the proposed fund in exchange for guarantees of trade unions, minimum wages, increased education, and other social spending.

- d. Sunset clause

A provision in an agreement such that it automatically ends after a specified period unless the participants explicitly agree to renew or extend it. This was wanted by the US as part of the renegotiated NAFTA, but the USMCA has a weaker version of it.

- e. BIT

Bilateral Investment Treaty, whose purposes are to help protect private investment, develop market-oriented policies in partner countries, and promote U.S. exports, according to the reading from the United States Trade Representative.

f. Standing

The term indicating whether a potential party to a legal action has the required characteristics to bring it. The Verrill reading states what must be true for petitioners to have standing to bring an anti-dumping case.