Study Questions
(with Answers)

Lecture 19
International Policies for Economic Development: Trade

Part 1: Multiple Choice

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

1. According to the reading by Ronald Bailey, what do immigrants have to do in order to benefit from a country's "intangible capital"?

    a. Just arrive in the country.
    b. Purchase it from those in the country who have it.
    c. Pay a tax to the host-country government.
    d. Nothing but live there for a sufficient amount of time; they'll acquire it automatically, but gradually.
    e. Trick question: immigrants themselves never do benefit from intangible capital; only their children do.

    Ans: *a*

2. According to the Infant Industry Argument

    a. Countries that allow children to work have an unfair advantage in international trade.
    b. Poor countries can foster economic development by using tariffs to protect new firms while they learn to become more productive.
    c. Costs of young firms are low because their workers lack seniority, and this contributes to comparative advantage.
    d. If a firm exports for a price lower than it charges in its domestic market, that constitutes unfair trade.
    e. When technological change creates a new industry, it is the innovating country that is likely to be able to export it.

Ans: *b*

3. Developing countries sometimes object that free trade will lead them to specialize in primary products. They view this as undesirable because

   a. Their costs of producing primary products are higher than the costs of producing them elsewhere.
   b. They believe that the prices of primary products tend to fall over time.
   c. Production of primary products is harmful to the environment.
   d. They would rather consume manufactured goods.
   e. Only poor countries export agricultural goods.

   Ans: *b*

4. Developing countries stand to gain from international trade because

   a. Trade enables them to specialize in producing where they have a comparative advantage.
   b. Trade gives them access to the greater variety of goods produced abroad.
   c. Trade subjects their local producers to greater competition.
   d. Trade allows them to produce larger amounts than they could consume themselves, taking advantage of increasing returns to scale.
   e. All of the above.

   Ans: *e*

5. Which of the following is ***not*** one of the reasons that increased exports are thought to increase a country's GDP?

   a. Exporting firms have an incentive to learn and adopt best practice technologies.
   b. An increase in demand for a country's exports constitutes an increase in aggregate demand.
   c. The revenue from exports adds to a country's international reserves of foreign exchange.
   d. Exporting firms face larger markets and can take advantage of economies of scale.
   e. Exports provide the means of paying for imports of capital goods.

   Ans: *c*

6. The experts of the Copenhagen Consensus 2008 Project were asked how they would allocate $75 billion on projects to aid developing countries. How much of that did they choose to spend on completing the Doha Development Agenda?

   a. None. They felt that more liberal trade would hurt developing countries.
   b. None. They favored trade liberalization, but said that its cost would be political, not economic.
   c. None. The Doha Development Agenda was not on the list of policies they considered.
   d. $5 billion. Though desirable to do, they saw other projects as having higher priority.
   e. $30 billion. Because trade liberalization offers the greatest and broadest benefits of any of the projects they were considering, they chose to spend most of their budget on it.

   Ans: b

7. According to the Food and Agriculture Organization (FAO) of the United Nations, cotton farmers in West Africa are hurt by competition with US cotton farmers because

   a. US farmers have a lower cost of producing cotton.
   b. US farmers are three times more productive than African farmers.
   c. African governments levy high taxes on their cotton farmers.
   d. The US government provides large subsidies to US cotton farmers.
   e. The rising world price of cotton puts African farmers at a disadvantage.

   Ans: d

8. Which of the following is **not** one of the policies or institutions advocated as part of the Washington Consensus?

   a. Tax reform
   b. Nationalization
   c. Financial liberalization
   d. Trade liberalization
   e. Fiscal discipline

   Ans: b

Part II: Short Answer

Answer in the space provided.

1. Define or explain:

   a. Terms of trade

   The average price of a country's exports compared to its imports.

   b. GSP

   Generalized System of Preferences: A system to reduced tariffs on certain imports from developing countries that developed countries have used to help them develop.

   c. Intangible capital

   Human capital and the value of institutions (See Bailey).

   d. Four Tigers

   The four countries of East Asia whose economic growth began shortly after the success of Japan: Hong Kong, South Korea, Singapore, and Taiwan.

   e. Demographic transition

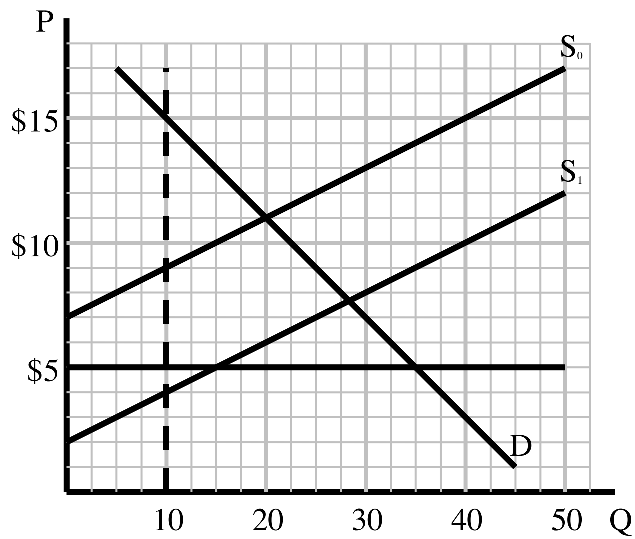
   The shift from high birth and death rates to low birth and death rates, which is a shift that typically accompanies successful economic development.

   f. METI

   Ministry of Economy, Trade and Industry: The ministry of the Japanese government that played a major role in guiding the industrial policies of Japan's economic development (formerly, before 2000, called MITI: Ministry of International Trade and Industry).

2. Suppose that the supply curve of an industry in an developing country is S_0 as shown, but that by producing 10 units for 2 years, producers would be able to learn to become more efficient and their costs would drop, at the end of that two years, by $5 per unit. Their supply curve would therefore become the one shown as S_1 thereafter. The world price is $5.

   Use the numbered grid in the figure to answer the following questions.



   a. If no policy is used at all, what will be the country's production and consumption of the good?

      Ans: Production = 0, Consumption = 35

   b. If the country uses a tariff to cause 10 units to be produced, how big would the tariff have to be (in specific terms) and what would be the dead weight loss from the tariff?

      Ans: A tariff of $4 would raise price to $9 and raise production to 10 units. This would increase producer surplus by $10 (the triangle left of S_0 between the price at which it commences production, $7, and the price with tariff, $9. It would reduce demand from 35 to 25, causing lost consumer surplus of $120 (4×25+½4×10). And the government collects $60 on 15 units of imports. So the dead weight loss is 120–10–60 = $50

   c. If the country instead pays a subsidy to producers equal to the tariff you just found, what would be the dead weight loss?

      Ans: A subsidy of $4 would also raise what the producers get to $9, but it would leave consumers unaffected, able to buy at the world price. Producers again gain $10, while the government now loses from its budget, paying 4×10 = $40 in subsidy. The net loss is 40–10 = $30, which is $20 less than the tariff.

   d. If the country returns to free trade after 2 years of either policy, with the supply curve now shifted down to S_1 as a result, what is the gain in producer surplus in years 3 and beyond? Assuming the future benefits are weighted the same as present benefits and costs, for how many years in each case (the tariff and the subsidy) would production at the lower cost have to continue to make the policy a net winner?

Ans: The gain in producer surplus is the area of the triangle bounded by the world price, S_1, and the vertical axis: $3\times15/2 = \$22.50$. The tariff cost \$50 for two years (see part b), for a total cost of \$100. Only after five years will the benefit to producers, at $5\times22.50 = \$112.50$, exceed this loss. The subsidy, on the other hand, costs the country only \$60 over two years, and will be surpassed by just three years of gain to producers, $3\times22.50 = \$67.50$.

3. The Copenhagen Consensus 2008 Project ranked a number of issues that are of concern to developing countries, giving high ranks to those where the benefits of addressing them were viewed as high relative to their costs, and giving low ranks to those where the opposite was true. Four of the issues are listed below. Insert a check mark in the appropriate column to indicate which were ranked high, and which were ranked low.

	High	Low
air pollution		✓
conflict		✓
diseases	✓	
malnutrition and hunger	✓	