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

    a. Must gain.
    b. May either gain or lose.
    c. Will neither gain nor lose.
    d. Must lose.
    e. 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

    a. Prior to NAFTA, Mexican workers were paid far below their productivity.
    b. After NAFTA, most U.S. firms would be unable to compete with imports from Mexico.
    c. After NAFTA, most U.S. firms would close their U.S. plants and move to Mexico.
    d. 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.
    e. After NAFTA, forcing Mexican workers to compete with more productive U.S. workers would drive their wages even lower.

    Ans: *d*

5. Mexico's international reserves

    a. Declined during the years that NAFTA was being negotiated, which was one of the reasons Mexico wanted the agreement.
    b. Rose until NAFTA went into effect, but have declined ever since.
    c. Fell during the year after NAFTA went into effect, precipitating the Peso Crisis.
    d. Rose until the Peso Crisis, which caused them to fall precipitously.
    e. Have risen steadily throughout the 1990s and since 2000.

    Ans: *c*

6. What effect did the NAFTA have on US unemployment?

   a. NAFTA caused the 1991 recession.
   b. NAFTA caused the 2001 recession.
   c. NAFTA caused US unemployment to rise by two percentage points, in 1994, when it went into effect.
   d. NAFTA caused US unemployment to rise by two percentage points, but not until 1995 when the Peso Crisis hit.
   e. NAFTA did not disrupt the more-or-less steady decline in the US unemployment rate that took place throughout the period between the 1991 and 2001 recessions.

   Ans: e

7. Which of the following is <u>not</u> currently part of the negotiations to form the Trans-Pacific Partnership?

   a. Japan
   b. The United States
   c. China
   d. Australia
   e. Peru

   Ans: c

8. Of the issues being negotiated in the TTIP, which is likely to be both most difficult and also most important, if it succeeds?

   a. Tariff elimination
   b. Opening public procurement
   c. Freedom of migration
   d. Reduction of regulatory barriers
   e. Labor standards

   Ans: d

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. The Maquiladora system permitted U.S. producers to take unfinished goods to __________________, perform further processing on them there, and bring them back into the United States with reduced tariffs. *Ans: Mexico*

   b. A predecessor of the U.S.-Canada FTA and the NAFTA was a free trade arrangement between the U.S. and Canada involving what product? __________________. *Ans: Automobiles (and auto parts)*

   c. Before bringing it to Congress for approval, the Clinton administration augmented the NAFTA by negotiating side agreements with Mexico, one of which was about __________________. *Ans: Environment or labor standards*

   d. Economists expected the NAFTA to have only very small effects on the United States, in part because U.S. tariffs were __________________. *Ans: Small*

e. Contrary to expectations, U.S. exports to Mexico declined a year or so after it went into effect. The reason for this decline was that the __________________ fell in value. *Ans: Peso; Mexican currency*

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

g. During the 2012 US presidential campaign, which of the candidates, Obama and Romney, argued for renegotiating NAFTA? ________________ *Ans: Neither*

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

		An example of	
An RTA is	✓	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. Maquiladora industry

Industry located in an export processing zone in Mexico, in which inputs are imported duty-free, and outputs then exported to the U.S. subject to tariff only on the Mexican value added.

b. 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.

c. Tequila Crisis

The financial crisis that occurred in Mexico in later 1994, including a depreciation of the Mexican peso of about 50%. Also called the Peso Crisis.

d. Mercosur

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

e. 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.

f. Cumulation

In the reading by Barfield, cumulation is explained as a feature of rules of origin in free trade agreements that extends the concept of origin to additional countries. In the TPP, the US does not want products from one TPP member with substantial inputs from another member to qualify for zero tariff under the FTA. Greater cumulation, as wanted by other countries, would allow this.