

Name _____

UMID _____

Midterm Exam - *Answers*
November 1, 2018

Answer on these sheets. Use the indicated point values as a guide to how extensively you should answer each question, and budget your time accordingly. Note that the last page of the exam (page 9) 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 need it.

The exam has a total of 60 points.

1. (12 pts.) Define or explain any six (6) of the following eight terms. (If you answer more than 6, I will grade only the first 6, so be sure to cross out any answers you don't want me to grade.)

a. Terms of trade: *The ratio of the price a country's exports to the price of its imports.*

b. National treatment: *Taxation, regulation, or other policies as applied to imported goods, once they have entered the country, that is the same as apply to domestically produced goods.*

c. Single undertaking: *Also called the "single package," this was the approach of the Uruguay Round of trade negotiations that everything that was agreed would be packaged together and that countries would have to accept or reject them all, not pick and choose among them (see Jackson).*

d. Specific tariff: *A tax on imports specified as units of currency per unit of the imported good.*

e. TRIPs: *The portion of the WTO dealing with intellectual property protection, which each member is required to provide and enforce.*

f. Trade Promotion Authority: *Informally called Fast Track, this is the commitment by the US Congress to bring trade agreements to an up-or-down vote, without amendments.*

g. USMCA: *The U.S.-Mexico-Canada Agreement, which is the name given to the renegotiated North American Free Trade Agreement.*

h. Section 232: *The section of US trade law that permits tariffs on imports that are regarded as threatening to national security.*

2. (12 pts.) True or False (circle one)

- a. The United States wins most of the dispute settlement cases that it brings against other countries for unfair trade practices.

True False Ans: True (See Porter)

- b. In the “semi-truce” agreed by President Trump when he met with European Commission President Jean-Claude Juncker, Trump promised to remove his tariffs on EU exports of steel and aluminum.

True False Ans: False (See Ward)

- c. The benefit to suppliers when their product is protected by a tariff is the increase in their revenue.

True False Ans: False (It’s the increase in producer surplus, which is much smaller.)

- d. The Swiss National Bank, in an effort to reduce the value of its currency, used a policy of negative interest rates.

True False Ans: True (See Blackstone)

- e. In 2015, the value of world exports fell, in part because the US dollar depreciated.

True False Ans: False (See WTO)

- f. Decisions in the WTO are made by consensus, which is interpreted as “no member present objecting.”

True False Ans: True (See Jackson Ch 2)

- g. In order to file for protection under the US anti-dumping law, a firm or group of firms must account for 50% or more of domestic production.

True False Ans: True (See Verrill)

- h. In the anti-dumping law of the European Union, anti-dumping duties are set equal to the dumping margin.

True False Ans: False (Not if the injury margin is smaller)

- i. The use of “buy-local” rules has increased substantially in recent years.

True False Ans: True (See Economist)

- j. The United Steelworkers Union opposed tariffs on automobile tires imported from China because its members would be hurt as consumers.

True False Ans: False (The union brought the complaint against tires from China because it represented workers in the tire industry.)

- k. A US safeguard tariff applied to imports of hot-rolled steel is expected to increase the US price of steel slab.

True False Ans: True (See Fetzer – slab is input to hot-rolled steel)

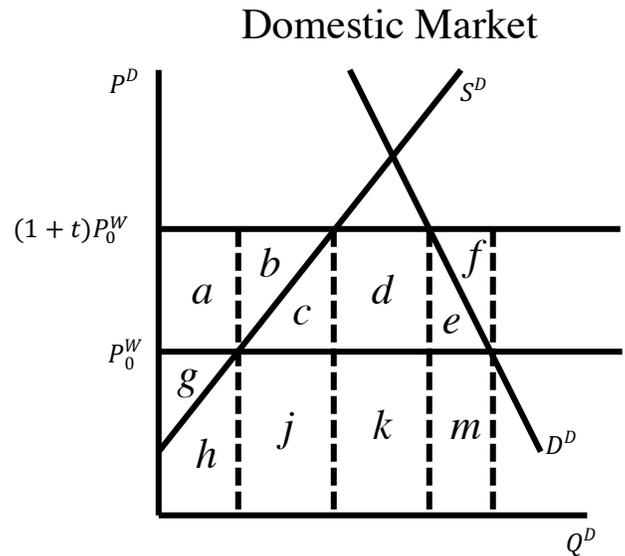
- l. Import tariffs were increased dramatically in the early 1930s and did not fall until negotiations to reduce them began in the late 1940s among the countries that signed onto the General Agreement on Tariffs and Trade.

True False Ans: False (See Baldwin)

3. (8 pts.) For each of the following place a check in just one column to indicate whether the transaction enters as a credit or a debit in the current or financial accounts of the US balance of payments.

	Current Account		Financial Account	
	Credit	Debit	Credit	Debit
a. A German corporation buys a US auto parts manufacturer.			✓	
b. University of Michigan President Schlissel earns dividends on stock in Toyota	✓			
c. New York University builds a campus in Singapore				✓
d. Boeing (a US company) sells ten jets to Saudi Arabia	✓			

4. (14 pts) The figure at the right shows the domestic market for a good in a small country, facing a world price of P_0^W and levying an *ad valorem* tariff, t . Using the labeled areas in the figure, identify the following effects of the tariff compared to free trade, always using plus (+) and/or minus (-) signs to indicate the direction of the change):



a. The change in revenue of suppliers:

$$+(a+b+c+j)$$

b. The change in total cost of suppliers:

$$+(c+j)$$

c. The change in producer surplus of suppliers:

$$+(a+b)$$

d. The change in expenditure by demanders:

$$+(a+b+c+d)-m$$

e. The change in consumer surplus of demanders:

$$-(a+b+c+d+e)$$

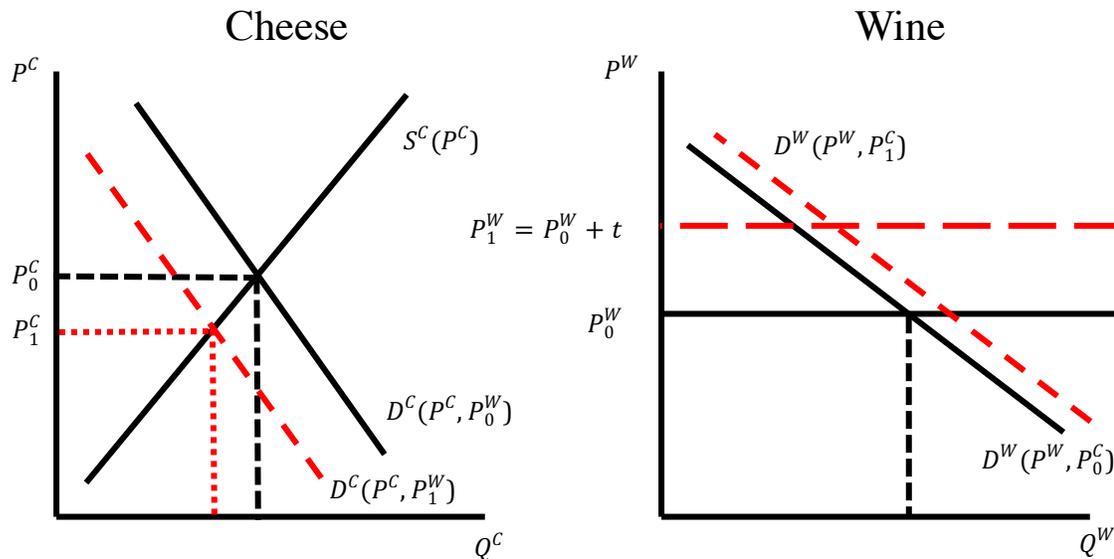
f. The change in tariff revenue:

$$+d$$

g. The change in welfare of the country as whole:

$$-(c+e)$$

5. (8 pts) Switzerland produces no wine but it produces a lot of cheese, which for the purpose of this question cannot be traded. Wine and cheese are complements for many consumers, but some other people consume only wine and still others only cheese. The graphs below show the Swiss domestic markets for (non-traded) cheese and for imported wine, with wine infinitely elastically available for the world price P_0^W .



- a. (6 pts) Show in the figure the effects of a tariff on imports of wine and on the quantities and prices of cheese and wine. Who gains and who loses (no need to say how much) from the tariff?

Ans: See above for quantities and prices. In the home country (Switzerland), suppliers of cheese lose (due to the fall in price). Those demanders who consume both wine and cheese, as suggested by their being complements, also lose from the rise in price of wine. Their loss is offset, but only partially, by the fall in price of cheese. Consumers who demand wine but not cheese are also worse off. Only consumers who buy only cheese, and no wine, benefit from the tariff, due to its effect on the price of cheese. Finally, the government and thus the tax payers benefit from the tariff revenue, so one could argue that people who consume no wine are better off, whether they consume cheese or not.

- b. (2 pts) Is there anyone in this scenario who would be expected to lobby for this tariff?

Ans: My answer would be no, since those who are most affected by the tariff (wine drinkers and cheese producers) lose. It's hard for me to imagine that either tax payers or those who consume cheese but not wine would be motivated to lobby for this tariff, but I can't say that you're wrong if you suggest that.

6. (6 pts) Earlier this year, President Trump placed a 10% tariff on imports of aluminum from most countries. In the space below, write a short essay explaining (without any formal analysis) the following:
- The basis under US law for this tariff.
 - The effect that this tariff has presumably had on markets for aluminum in the US and the world.
 - Its effects on the well-being of people in the US and abroad.

Ans: Trump's tariffs on aluminum (and steel, but this doesn't ask about that) were put in place on the basis of national security. The argument seems to be that a country without a robust industry producing aluminum will be insecure, though exactly how that would be is not obvious. The tariff was placed on exports of most of America's allies, from whom one might suppose we could import aluminum if needed.

Like any tariff, this is expected to raise the price of the imported product inside the US and lower its price abroad, although our analysis in class suggested that the latter effect would be very small. Thus aluminum will rise in price in the US, increasing the cost of all products that are made with aluminum. This will hurt US consumers, and also make such US firms less competitive with imports and in competition abroad as exporters US exporters.

Firm's within the US that produce aluminum should gain from this tariff, as they get a higher price and are able to sell more in competition with the higher priced imported product. This gain will go to the owners of these firms and probably also to their workers, who may be paid a higher wage or paid for more hours of work. Aside from this group, however, everyone else in the US will be hurt by the higher prices of products that use aluminum as an input. That loss is larger than the gain of producers, but it is spread over such a large group (almost everybody) that few may notice. Particular producers of products that use aluminum will complain about their higher costs (they are already), but their losses too are individually much smaller than the gains to aluminum producers.

To the extent that the world price of aluminum drops due to the US tariff, foreign aluminum producers will be hurt and foreign consumers helped, just the mirror image of all I've just said for the US. But these effects are likely to be quite small, as the world market is so large. There will be a few foreign producers of aluminum – both firms and countries – that will be hurt particularly, and they will no doubt suffer.

It is also likely (as indeed has already occurred) that foreign countries will retaliate against this tariff (and the one on steel) with tariffs on US exports. This opens up other whole groups of winners and losers depending on which products get the foreign tariffs.

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