

Name _____

UMID _____

Midterm Exam - *Answers*
February 22, 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. RCEP: *Regional Comprehensive Economic Partnership: a free trade agreement being negotiated among 16 countries of Asia, including the 10 members of ASEAN (the Association of South East Asian Nations) and those with whom ASEAN already has FTAs, including China. It is thought to be China's major effort to bind its neighbors to itself through trade.*

b. Brexit: *The move by the United Kingdom to leave European Union.*

c. International Trade Administration: *The unit of the US government, part of the Department of Commerce, that decides whether imports are dumped by foreign firms or subsidized by foreign governments.*

d. Financial account surplus (of the US): *The excess of credits over debits in the financial account, which consists positively of changes in the holdings of US assets by foreigners and negatively of changes in the holding of foreign assets by the US.*

e. GATS: *The WTO General Agreement on Trade in Services, which intends (not yet very successfully) to achieve national treatment for foreign service providers in WTO member countries.*

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

g. Variable Levy: *A tariff that is adjusted automatically in response to changes in the world price of an import in order to stabilize the domestic price of the good. Used in the European Union as part of its Common Agricultural Policy.*

h. Injury margin: *The portion of the price difference for a dumped or subsidized good that is regarded as causing injury. In the EU, an anti-dumping or countervailing duty will be set equal to this if it is smaller than the dumping margin (which measures the extent of dumping or subsidy).*

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

- a. According to the Gravity Model of Trade, trade between two countries is proportional to the product of their sizes (measured by GDP) and inversely proportional to the square of the distance between them.

True False Ans: False (not the square)

- b. The Appellate Body of the World Trade Organization became understaffed when the Obama administration blocked the reappointment of one of its members because of a decision he had made against the United States.

True False Ans: True (Trump has blocked further appointments, but it was the Obama administration that did this first)

- c. The Trump administration has insisted that both the NAFTA agreement with Canada and Mexico and the KORUS agreement with South Korea be completely renegotiated.

True False Ans: False (KORUS is only to be amended)

- d. China is seeking “market economy status” because that will require other countries to use Chinese prices and costs as the basis for complaints of dumping.

True False Ans: True

- e. Economic sanctions are popular politically, but they hardly ever work to accomplish their objectives.

True False Ans: False (They work maybe half the time)

- f. US producers of berries would like to see US anti-dumping law changed to permit cases to be brought on the basis of month-long seasons rather than year-long seasons.

True False Ans: True

- g. President Trump wishes to take credit for levying tariffs on imported washing machines, but in fact the tariffs were levied under US Section 201, under which the President does not have the option of not levying the tariffs.

True False Ans: False

- h. The effective rate of protection can never be higher than the nominal rate of protection.

True False Ans: False

i. A large country can benefit by using a tariff only if it permits its quantity of imports to rise.

True False Ans: False

j. A country's currency will be viewed as overvalued based on Purchasing Power Parity if the average prices of goods there are higher, at prevailing exchange rates, than in other countries.

True False Ans: True

k. In the international accounts, "secondary income" is international transfer payments.

True False Ans: True

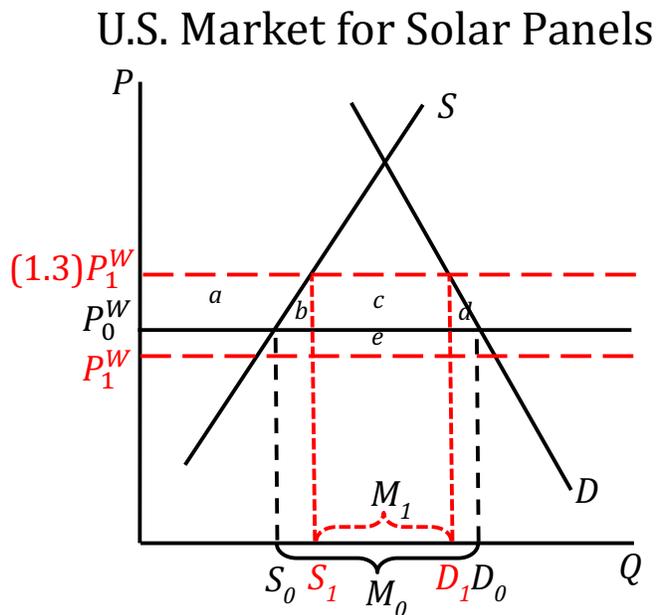
l. In 2015, the value of world exports fell, primarily because the US dollar depreciated reducing US imports.

True False Ans: False (It was the dollar appreciating that was one of the two causes of the fall in world exports.)

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 resident of Detroit is paid for work in Windsor, Canada | ✓ | | | |
| b. The US government provides foreign aid to Pakistan | | ✓ | | |
| c. Donald Trump borrows money from a bank in Russia | | | ✓ | |
| d. General Motors (a US company) pays a dividend to its German stockholders | | ✓ | | |

5. (18 pts.) On January 22, 2018, President Trump announced tariffs of 30% on imports of solar panels. (The actual policy was a bit more complicated than this, but you need not consider such complications.)
- a. (8 pts) In the space below, draw a diagram to illustrate the effects of this tariff in partial equilibrium and write a brief essay using this diagram to explain the various economic effects of this tariff.



Ans: The diagram shows a partial equilibrium analysis of the US domestic market for solar panels, with initial world price P_0^W and initial quantities S_0 , D_0 , and M_0 supplied, demanded, and imported. The tariff, $t=30\%$, causes the US to import less solar panels and, because the US is a large part of the world market, causes the world price of panels to fall. The model does not tell us how much it falls, and in the figure it is shown as falling only a small amount, to P_1^W . The new domestic price is 30% above the new world price, thus $(1.3)P_1^W$, and is above the initial price by some amount less than 30%. The rise in price causes increased production of solar panels and increased employment in those firms. It also causes a reduction in demand for solar panels and increased revenue for the government

Areas labelled a , b , c , d , and e illustrate the welfare effects of this tariff in the US: Suppliers gain a , demanders lose $(a+b+c+d)$, and the government collects tariff revenue of $(c+e)$. The net effect on the US is a net gain of $(e-b-d)$, which will be a loss if $(b+d) > e$. As drawn, it appears that $(b+d) < e$, so that the US gains from the tariff, but that would not be the case if the world price had fallen by less.

- b. (6 pts) In the space below, explain briefly under what US law or provision of the WTO/GATT he was able to do this legally, and what procedure(s) had been followed prior to his levying the tariff.

Ans: This was a “safeguard” tariff (also known as the “escape clause”) and was done under Section 201 of US trade law and under the Safeguards Clause of the GATT/WTO. These permit temporary, non-discriminatory tariffs on imports that have been found to cause serious injury. In the US, the injury determination is done by the United States International Trade Commission, an independent agency of the US government. The President may choose to not levy the tariff, or to levy a smaller one than recommended by the USITC, but in this case he did not.

- c. (4 pts) Outside of the economic analysis that you did in part (a), what other effects would you expect to observe in the US and the world as a result of this tariff?

Ans: These effects might include:

- *Retaliation by foreign countries, especially China, in the form of tariffs on US exports.*
- *Higher cost and thus higher prices for US solar panel installers who would lose sales and reduce employment as a result.*
- *Foreign solar panel producers might build factories in the US to get behind the tariffs*
- *Foreign countries may file complaints with the World Trade Organization, hoping to get these tariffs ruled illegal and have them removed.*
- *To the extent that the world price of solar panels falls due to this tariff, it will stimulate the installation of solar panels in the rest of the world.*

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