

Name _____

UMID _____

Final Exam
December 18, 2018
Answers

Answer on these sheets. Note that the last page of the exam (page 12) 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 90 points.

1. (12 points) The WTO includes many rules. Some rules say what member countries *must* do, some what they *must not* do, and some rules say things that they *may* (but need not) do, so long as they do them in specified ways. For each of the rules listed below, indicate by circling the correct response which category each belongs to.

Rule	Must	Must Not	May	Not a WTO rule	
Reduce tariffs on imports	Must	Must Not	May	Not a WTO rule	<i>Not a WTO rule</i>
Raise tariffs on imports	Must	Must Not	May	Not a WTO rule	<i>May</i>
Levy anti-dumping duties against dumped imports	Must	Must Not	May	Not a WTO rule	<i>May</i>
Subsidize exports of goods	Must	Must Not	May	Not a WTO rule	<i>Must Not</i>
Treat imported goods, once inside the country, the same as domestically produced goods	Must	Must Not	May	Not a WTO rule	<i>Must</i>
Set tariffs above “bound” levels	Must	Must Not	May	Not a WTO rule	<i>Must Not</i>
Abide by decision of Dispute Settlement Mechanism or suffer retaliation	Must	Must Not	May	Not a WTO rule	<i>Must</i>
If levying safeguards a tariff, apply it to imports from all countries	Must	Must Not	May	Not a WTO rule	<i>Must</i>
If levying countervailing duty, apply it to imports from all countries	Must	Must Not	May	Not a WTO rule	<i>Must Not</i>
Enact and enforce intellectual property rights	Must	Must Not	May	Not a WTO rule	<i>Must</i>
Enact and enforce adequate labor standards	Must	Must Not	May	Not a WTO rule	<i>Not a WTO rule</i>
If levying an anti-dumping duty, set it equal to the minimum of the dumping margin and the injury margin	Must	Must Not	May	Not a WTO rule	<i>May</i>

- f) *Section 232: The portion of US trade law that permits tariff on imports if they are a threat to national security. This is the basis of Trump's tariff on steel and aluminum, and it is being investigated for possible tariffs on cars and car parts.*
- g) *Forced technology transfer: This refers to China's practice of requiring that foreign companies investing in China enter into joint ventures, with the result that the companies' technologies become the property of their Chinese partners. This is one of the practices that the US and others view as unfair and have been the justification by the US of its tariffs on Chinese exports under Section 301.*
- h) *Quota rent: The profit that the holder of a license to import under a quota earns from buying the good at the world price and selling it inside the importing country at the higher price that results from the quota. The value of the rent is the tariff equivalent of the quota multiplied by the quantity of imports.*
- i) *Prohibitive tariff: A tariff that is at or above the level at which imports of the protected good fall to zero.*
- j) *GATS: The General Agreement on Trade in Services, this is one of the three parts of the WTO and it seeks to move countries toward freer trade in services by getting them to specify categories of services for which they will grant national treatment to foreign service providers.*

- k) Consensus, as applied in WTO decision making: *It means no member present objecting. Thus it requires agreement only by all of those members present at the meeting, not by those members not present.*
- l) Trade Promotion Authority: *Also called Fast Track, this is the commitment by Congress to consider trade legislation within time constraints and subject to an up or down vote without amendments.*
- m) Single market: *The integration of markets within the European Union, including the free movement of most goods, services, money, and people.*
- n) Variable Levy: *Part of the Common Agricultural Policy of the European Union, this is a tariff the size of which is adjusted as prices of imported agricultural products change in order to hold constant the resulting domestic price.*
- o) Column 2 tariff: *The usually higher-than-MFN tariff rates that are applied to countries with whom the US does not have normal trade relations.*
- p) Heckscher-Ohlin Theorem: *The result of the Heckscher-Ohlin trade model that countries have a comparative advantage in, and will therefore export, those goods that use relatively intensively their relatively abundant factors.*

- q) *Internal economies of scale: A feature of a firm's technology that causes its average cost to fall as it expands all of its inputs in the same proportion (in contrast to external economies of scale where costs fall only as a result of expansion of the industry, not the firm).*
- r) *Diagonal cumulation: In an FTA, allowing inputs from non-members to qualify under the rules of origin, typically if the members each have other FTAs with those non-members.*
- s) *Exempted sector: A sector in which a country does not eliminate the tariff on imports from its FTA partner.*
- t) *The non-market-economy-trade provision of USMCA: The requirement that Canada and Mexico must notify the US prior to negotiating any trade agreement with a non-market economy (i.e., China) and that the US may withdraw from USMCA if they enter an FTA with such economy.*
- u) *Trade Adjustment Assistance: The US program providing help to firms and workers that have been displaced by imports. For workers the help includes extended unemployment compensation, funds for retraining and relocation, and help with health insurance.*

3. (19 pts.) True or False (circle one)

- a. Under President Trump, the United States became the first country to block the re-appointment of a member of the WTO's Appellate Body.

True False *Ans: False (This was first done under Obama)*

- b. As part of the negotiated amendments to the free trade agreement between the United States and South Korea, the US was allowed to keep its 25% tariff on imports of light trucks for more years than permitted previously.

True False *Ans: True (for 20 more years, until 2041)*

- c. In the vote on Brexit in 2016, a majority of voters chose to remain in the EU, but the decision was to leave because Scotland, Wales, and Northern Ireland were given greater weight in the outcome than was England.

True False *Ans: False (52% voted to leave)*

- d. The US tariffs on imported washing machines were recommended by the independent US International Trade Commission, but President Trump could have chosen not to levy the tariffs.

True False *Ans: True (These were safeguard tariff that the president has the option not to use)*

- e. The US recently raised tariffs on exports from Rwanda to higher than its MFN rates, in retaliation for Rwanda banning imports of used clothing.

True False *Ans: False (The US did raise tariffs, but only to the MFN rates. Tariffs had been below those levels under preferences provided as part of the US African Growth and Opportunity Act.)*

- f. A specific tariff is a tariff levied on a single product in the tariff schedule.

True False *Ans: False (It's a tariff defined as an amount of currency per unit of the good.)*

- g. The World Trade Organization permits the United States to restrict shipping in national waters to US ships.
- True False *Ans: True (This right was grandfathered into the WTO, and allows the US to continue restricting shipping under the Jones Act.)*
- h. The role of the United States Export-Import Bank is to negotiate increased exports of critical products to other countries in return for importing more from them.
- True False *Ans: False (It just makes or guarantees loans to foreign buyers of US exports.)*
- i. In an anti-dumping case in the European Union, the duty is set at either the dumping margin or the injury margin, whichever is smaller.
- True False *Ans: True (This is the “lesser duty rule”.)*
- j. The Chinese government is committed to eliminating state-owned enterprises.
- True False *Ans: False (It intends to reform them, it says, but still keep a “preponderance of public ownership”.)*
- k. Assuming perfect competition, an export subsidy can be beneficial to the country using it if the country is large enough to alter the world price.
- True False *Ans: False (The subsidy will only worsen its terms of trade, not improve it.)*
- l. In the Standard Trade Model (of the KOM textbook), growth that is neutral (neither export-biased nor import-biased) will worsen the country’s terms of trade.
- True False *Ans: True*
- m. Beginning in the 1980s, the wages of skilled and educated workers in the United States began to rise relative to the wages of unskilled and less educated workers.
- True False *Ans: True (See Freeman reading.)*

- n. In the monopolistic competition model of the textbook, a move from autarky to free trade causes the number of firms in each country to increase.

True False *Ans: False (The number in each country falls.)*

- o. When preferential liberalization of trade in services causes trade diversion, this is less likely to be harmful than trade diversion in goods because the barriers to trade in services are real.

True False *Ans: True (Reducing those barriers lowers real costs, rather than reducing government tariff revenue. See WTO reading.)*

- p. Under US Section 201, a tariff will be provided only if imports have been the most important cause of injury.

True False *Ans: True*

- q. In the EU (but not the US), an anti-dumping duty is subject to a “proportionality test.”

True False *Ans: True (See the Jakob reading.)*

- r. China is insisting that it be given “market economy status,” because without that the US is allowed by the WTO to levy tariffs on its exports under Section 301.

True False *Ans: False (Market-economy status is relevant to anti-dumping, not Section 301.)*

- s. The WTO permits countervailing duties against subsidized imports only if those subsidies are “generally available.”

True False *Ans: False (Just the opposite: the subsidy must be specific to justify a CVD.)*

4. (9 points) Use the graph below of domestic supply and demand for a good in a small open economy to calculate the following:

a) If the world price is \$3 and the import tariff is 100%,

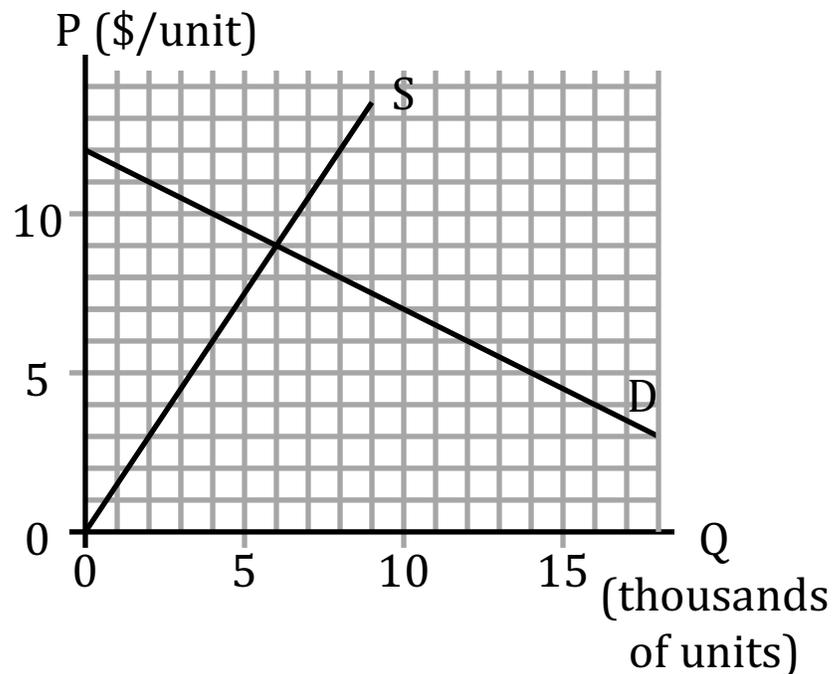
The domestic price	<u>\$6.00</u>
The quantity of imports	<u>8,000</u>
The tariff revenue	<u>\$24,000</u>

b) If the world price is \$8 and the import tariff is \$4.00 per unit

The domestic price	<u>\$9.00</u>
The quantity of the good demanded domestically	<u>6,000</u>
The tariff revenue	<u>\$0</u>

c) If the world price is \$12 and the import tariff is \$1.00 per unit

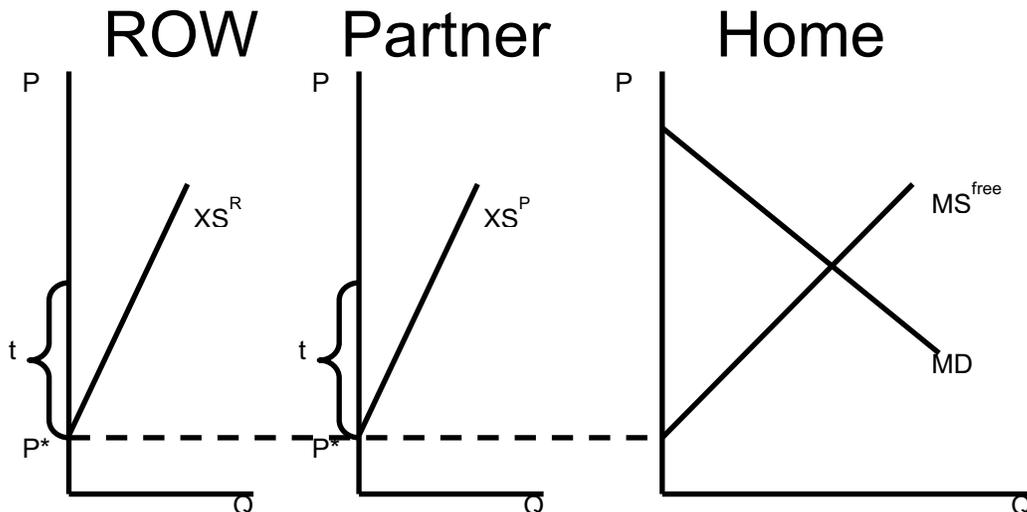
The domestic price	<u>\$12.00</u>
The quantity of the good supplied domestically	<u>8,000</u>
The tariff revenue	<u>\$0</u>

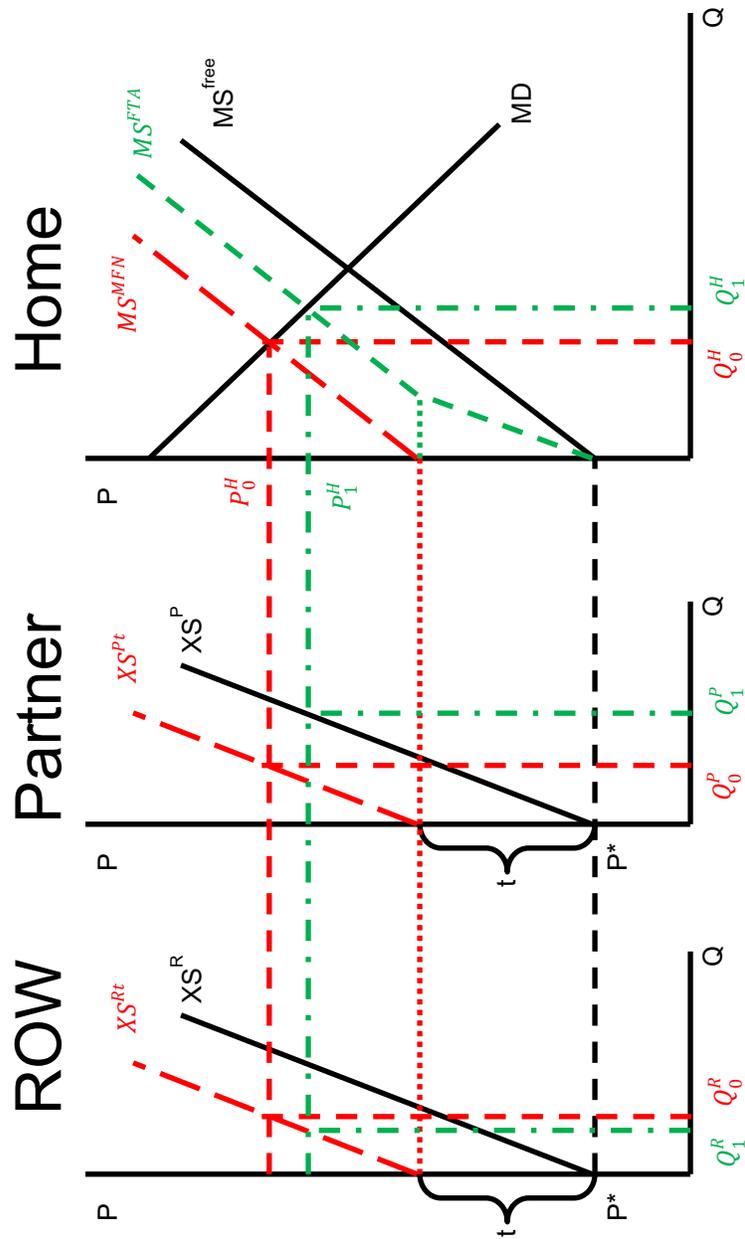


4. (16 points) The graph below is adapted from the lecture on free trade agreements. It shows a situation, with free trade, in which the home country on the right has the import demand curve shown. It faces an export supply curve XS^P from a potential FTA partner country and an export supply curve XS^R from the rest of world. These two export supply curves happen to be identical, and they sum to the free-trade import supply curve, MS^{free} , shown at the right. Following the instructions below, show in version of this figures on the next page first what will happen when the tariff, t , shown in the left and middle panels, is applied on an MFN basis to both exporters. Then show what will happen if the Home country enters into a free trade agreement with the Partner country while keeping its tariff, t , on ROW.
- First draw the export supply curves of ROW and Partner, as viewed by home, once they incorporate the tariff as part of their costs, and label these XS^{Rt} and XS^{Pt} .
 - Use these to construct the import supply curve facing Home, MS^{MFN} , and show the resulting MFN equilibrium in the panel on the right. Label the MFN quantity and price of Home imports Q_0^H and P_0^H . Also, find the quantities exported by ROW and Partner in the left and middle panels, and label them Q_0^R and Q_0^P respectively. This is the initial equilibrium for the comparisons below.
 - Now let Home form a FTA with Partner. Construct the new import supply curve in the rightmost panel, and label it MS^{FTA} .
 - Using that, identify the new quantity and price of imports in Home, and label them Q_1^H and P_1^H .
 - Show in the left and middle panels the resulting quantities of exports by ROW and Partner, and label them Q_1^R and Q_1^P respectively.
 - Using the quantities that you have labeled in the figure, state here the quantity of trade creation and the quantity of trade diversion.

Trade creation: $\underline{Q_1^H - Q_0^H}$

Trade diversion: $\underline{Q_0^R - Q_1^R}$





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