

A Sample of multiple choice and essay questions (copy righted materials)

The Political Economy of Trade Theory

■ Multiple Choice Questions

1. The efficiency case made for free trade is that as trade distortions such as tariffs are dismantled and removed,
 - (a) government tariff revenue will decrease, and therefore national economic welfare will decrease.
 - (b) government tariff revenue will decrease, and therefore national economic welfare will increase.
 - (c) deadweight losses for producers and consumers will decrease, hence increasing national economic welfare.
 - (d) deadweight losses for producers and consumers will decrease, hence decreasing national economic welfare.
 - (e) None of the above.

Answer: C

3. It is argued that special interest groups are likely to take over and promote protectionist policies, which may lead to an increase in national economic welfare. This argument leads to
 - (a) a presumption that in practice a free trade policy is likely to be better than alternatives.
 - (b) a presumption that trade policy should be shifted to Non-Governmental Organizations, so as to limit taxpayer burden.
 - (c) a presumption that free trade is generally a second-best policy, to be avoided if feasible alternatives are available.
 - (d) a presumption that free trade is the likely equilibrium solution if the government allows special interest groups to dictate its trade policy.
 - (e) None of the above.

Answer: A

8. The domestic market failure argument is a particular case of the theory of
 - (a) the optimum, or first-best.
 - (b) the second best.
 - (c) the third best.
 - (d) the *sufficing principle*.
 - (e) None of the above.

Answer: B

9. The difficulty of ascertaining the right *second-best* trade policy to follow
- (a) reinforces support for the *third-best* policy approach.
 - (b) reinforces support for increasing research capabilities of government agencies.
 - (c) reinforces support for abandoning trade policy as an option.
 - (d) reinforces support for free-trade options.
 - (e) None of the above.

Answer: D

13. The fact that trade policy often imposes harm on large numbers of people, and benefits only a few may be explained by
- (a) the lack of political involvement of the public.
 - (b) the power of advertisement.
 - (c) the problem of collective action.
 - (d) the basic impossibility of the democratic system to reach a fair solution.
 - (e) None of the above.

Answer: C

14. Protectionism tends to be concentrated in two sectors:
- (a) agriculture and clothing.
 - (b) high tech and national security sensitive industries.
 - (c) capital and skill intensive industries.
 - (d) industries concentrated in the South and in the Midwest of the country.
 - (e) None of the above.

Answer: A

15. Judging by the changes in the height of tariff rates in major trading countries, the world has been experiencing a great
- (a) trade liberalization.
 - (b) surge of protectionism.
 - (c) lack of progress in the trade-policy area.
 - (d) move towards regional integration.
 - (e) None of the above.

Answer: A

19. A trade policy designed to alleviate some domestic economic problem by exporting it to foreign countries is known as a(n)
- (a) international dumping policy.
 - (b) countervailing tariff policy.
 - (c) beggar thy neighbor policy.
 - (d) trade adjustment assistance policy.
 - (e) None of the above.

Answer: C

20. The General Agreement on Tariffs and Trade and the World Trade Organization have resulted in
- (a) termination of export subsidies applied to manufactured goods.
 - (b) termination of import tariffs applied to manufactures.
 - (c) termination of import tariffs applied to agricultural commodities.

- (d) termination of international theft of copyrights.
- (e) None of the above.

Answer: E

21. The General Agreement on Tariffs and Trade and the World Trade Organization have resulted in
- (a) the establishment of universal trade adjustment assistance policies.
 - (b) the establishment of the European Union.
 - (c) the reciprocal trade clause.
 - (d) reductions in trade barriers via multilateral negotiations.
 - (e) None of the above.

Answer: D

22. Trade theory suggests that Japan would gain from a subsidy the United States provides its grain farmers if the gains to Japanese consumers of wheat products more than offsets the losses to Japanese wheat farmers. This would occur as long as Japan
- (a) is a net importer in bilateral trade flows with the United States.
 - (b) is a net importer of wheat.
 - (c) has a comparative advantage in wheat.
 - (d) has an absolute advantage in producing wheat.
 - (e) None of the above.

Answer: B

23. Countervailing duties are intended to neutralize any unfair advantage that foreign exporters might gain because of foreign
- (a) tariffs.
 - (b) subsidies.
 - (c) quotas.
 - (d) Local-Content legislation.
 - (e) None of the above.

Answer: B

24. Throughout the post-World War II era, the importance of tariffs as a trade barrier has
- (a) increased.
 - (b) decreased.
 - (c) remained the same.
 - (d) fluctuated wildly.
 - (e) demonstrated a classic random walk with a mean-reversion tendency.

Answer: B

25. In 1980 the United States announced an embargo on grain exports to the Soviet Union in response to the Soviet invasion of Afghanistan. This embargo was mainly resisted by
- (a) U.S. grain consumers of bread.
 - (b) U.S. grain producers.
 - (c) foreign grain producers.
 - (d) U.S. communists.
 - (e) None of the above.

Answer: B

26. Export embargoes cause greater losses to consumer surplus in the target country

- (a) the lesser its initial dependence on foreign produced goods.
- (b) the more elastic is the target country's demand schedule.
- (c) the more elastic is the target country's domestic supply.
- (d) the more inelastic the target country's supply.
- (e) None of the above.

Answer: D

27. The strongest political pressure for a trade policy that results in higher protectionism comes from
- (a) domestic workers lobbying for import restrictions.
 - (b) domestic workers lobbying for export restrictions.
 - (c) domestic workers lobbying for free trade.
 - (d) domestic consumers lobbying for export restrictions.
 - (e) domestic consumers lobbying for import restrictions.

Answer: A

29. In 1990 the United States imposed trade embargoes on Iraq's international trade. This would induce smaller losses in Iraq's consumer surplus the
- (a) less elastic Iraq's demand schedule.
 - (b) more elastic Iraq's demand schedule.
 - (c) greater is Iraq's dependence on foreign products.
 - (d) more inelastic is Iraq's supply schedule.
 - (e) None of the above.

Answer: B

30. The World Trade Organization provides for all of the following except
- (a) the usage of the most favored nation clause.
 - (b) assistance in the settlement of trade disagreements.
 - (c) bilateral tariff reductions.
 - (d) multilateral tariff reductions.
 - (e) None of the above.

Answer: C

31. Which organization determines procedures for the settlement of international trade disputes?
- (a) World Bank
 - (b) World Trade Organization
 - (c) International Monetary Organization
 - (d) International Bank for Reconstruction and Development
 - (e) The League of Nations

Answer: B

32. The WTO's intervention against clean air standards
- (a) has earned it universal approval.
 - (b) was done in order to limit national sovereignty.
 - (c) has resulted in much criticism.
 - (d) has resulted in much criticism among professional economists.
 - (e) None of the above.

Answer: C

35. Today U.S. protectionism is concentrated in
- (a) high tech industries.
 - (b) labor-intensive industries.
 - (c) industries in which Japan has a comparative advantage.
 - (d) computer intensive industries.
 - (e) capital-intensive industries.
- Answer: B
36. The reason protectionism remains strong in the United States is that
- (a) economists can produce any result they are hired to produce.
 - (b) economists cannot persuade the general public that free trade is beneficial.
 - (c) economists do not really understand how the real world works.
 - (d) the losses associated with protectionism are diffuse, making lobbying by the public impractical.
 - (e) None of the above.
- Answer: D
40. When the U.S. placed tariffs on French wine, France placed high tariffs on U.S. chickens. This is an example of:
- (a) deadweight losses
 - (b) multilateral negotiations
 - (c) bilateral trade negotiations
 - (d) international market failures
 - (e) none of the above
- Answer: E
41. The quantitative importance of U.S. protection of the domestic clothing industry is best explained by the fact that
- (a) this industry is an important employer of highly skilled labor
 - (b) this industry is an important employer of low skilled labor
 - (c) most of the exporters of clothing into the U.S. are poor countries.
 - (d) a politically well organized sector in the U.S.
 - (e) None of the above
- Answer: D

■ Essay Questions

1. Developing countries have often attempted to establish cartels so as to counter the actual or perceived inexorable downward push on the prices of their exported commodities. OPEC is the best well known of these. How are such cartels expected to help the developing countries? At times importing countries profess support for such schemes. Can you think of any logical basis for such support? How are cartels like monopolies, and how are they different from monopolies. Why is there a presupposition among economists that such schemes are not likely to succeed in the long run?

Answer: Such cartels are expected to shift the exporters' terms of trade in their favor. Also they are expected to produce the maximum profit, which the market will bear. Importing countries may benefit from the price stability generated by the cartel. Cartels are like monopolies in that their total output is the same as that which would be generated by a single monopoly. They differ from monopolies in that the monopoly profits need to be divided among the producing countries, which have different cost structures.

2. The United States appears at times to have a totally schizophrenic attitude toward protectionism. The United States was the country that proposed the establishment of the World Trade Organization as early as the late 1940s, and was also the only industrialized country that refused to ratify this at that time. The United States has consistently argued on the side of multinational free trade in GATT Rounds, and yet maintains many protectionist laws such as those which reserve oil shipments from Alaska to U.S. flag carriers. How can you explain this apparent lack of national consistency on this issue?

Answer: This reflects the fact that international trade typically has many winners and relatively fewer, but politically powerful losers. Short of guaranteed (constitutional?) non-conditional compensatory mechanisms, the basic conflict between these two groups will always be there.

3. Presumably, since the United States is a *large country* in many of its international markets, a positive optimum tariff exists for this country. It follows therefore that when any legislator or government official who promotes zero-tariff free trade policies, is by definition not acting in the public's best interest. Discuss.

Answer: Technically this is true. However, if the tariff imposing country is large enough to make a substantial difference in its welfare by seeking an optimum tariff, then it cannot hope to remain invisible, as its policies are substantially harming its trade partners. Foreign repercussions are almost a certainty. In such a "game" it is not at all certain that seeking the optimum tariff dominates alternative strategies.

4. It may be demonstrated that any protectionist policy, which effectively shifts real resources to import competing industries or sectors will harm export industries or sectors. This may, for example, happen by the strengthening U.S. dollar in the foreign exchange market. Would you propose therefore that export industries lobby against protectionism in International Trade Commission proceedings? What of consumer advocates? Discuss the pros and the problems of such a suggestion.

Answer: Actually this is an interesting idea. It is well known that the public interest is put on hold as the ITC considers only the squeaky wheels of those allegedly hurt by trade. While "consumers" may be too amorphous a group to successfully organize and pursue a political agenda, the exporters and consumer advocates may be able to form a counter weight to the import competing industries.

5. It has been claimed that foreign governments have attempted to influence votes in the U.S. that would promote policies of protectionism within the U.S. On the surface this appears to be totally illogical and counter intuitive, as this would presumably lessen the possibilities of foreigners' exports to the U.S.

Answer: This would make sense only if the form of protectionism is a tariff. However, if it is a quota, then the scarcity rents may be captured by established foreign producers. Hence, the reaction of the Japanese to automobile quotas was to dramatically increase the high-end, highly profitable automobiles. This would be even more self-evident if the protectionism took the form of a Voluntary Export Restraint (VER), or a detailed formalized bilateral cartel, such as the old Multi-Fibre Agreement.