Reading 17

INTERNATIONAL TRADE

1. (A) **economic union.**

Explanation

The two countries are a part of an economic union. In an economic union, there is (1) free trade among members, (2) common restrictions (tariffs) on imports from non-members, (3) free movement of production factors (labor), and (4) common economic institutions and coordination of economic policies. While a customs union has common tariffs on imports from non-union countries and free trade, it does not allow workers to cross the borders freely and does not have common economic institutions. A monetary union requires all of the listed items and a common currency.

(Module 17.1, LOS 17.c)

2. (A) **protect industries in which they have a comparative advantage.**

Explanation

If a particular country enjoys a comparative advantage in a particular industry, no protection is needed.

(Module 17.1, LOS 17.b)

3. (B) **as a tax on imports, and a quota limits the quantity that can be imported.**

Explanation

The difference between a tariff and a quota is that a tariff is a tax imposed on imported goods, while a quota is an import quantity limitation. Both are imposed by individual countries.

(Module 17.1, LOS 17.b)

4. (C) **both Country P and Country Q.**

Explanation

Both countries in an international trade relationship benefit in the long run. Costs of international trade tend to be short-run effects in specific domestic industries.

(Module 17.1, LOS 17.a)

5. (B) **set of economic policies.**

Explanation

An economic union is a common market that has also adopted common institutions and economic policy. Both common markets and economic unions adopt a common set of trade restrictions with non-members. Neither requires the adoption of a common currency, which is a characteristic of a monetary union.

(Module 17.1, LOS 17.c)

6. (C) **The costs of trade primarily affect those in domestic industries that compete with imports.**

Explanation

The benefits of trade are greater than the costs for the overall economy, but those in domestic industries competing with imports may suffer costs in the form of reduced profits or employment.

(Module 17.1, LOS 17.a)

7. (C) **Domestic consumers.**

Explanation

Domestic consumers in the country that imposes a tariff are harmed because they must pay higher prices for the good. Tariffs benefit domestic producers of the good by effectively imposing a price increase on competing imports. A tariff does not affect foreign consumers of the good.

(Module 17.1, LOS 17.b)

8. (B) **Customs union, economic union, monetary union.**

Explanation

The order by degree of economic integration (from least to most integrated) is as follows: free trade areas, customs union, common market, economic union, and monetary union.

(Module 17.1, LOS 17.c)

9. (C) **monetary union.**

Explanation

A monetary union, such as the Euro zone, is the most integrated type of trading bloc or regional trade agreement because the members adopt a common currency.

(Module 17.1, LOS 17.c)

10. (B) quotas.

Explanation

Quotas are limits on the amounts of imports allowed into a country in a period of time. Government payments to firms that export goods are known as export subsidies. Taxes on imported goods collected by the government are known as tariffs.

(Module 17.1, LOS 17.b)

11. (A) Domestic consumers.

Explanation

A tax imposed on imports is called a tariff, which benefits domestic producers and

domestic governments. Domestic consumers lose through higher prices, less choice of products, and lower quality products.

(Module 17.1, LOS 17.b)

12. (C) only one is correct.

Explanation

Forsythe is correct. A primary reason why trade restrictions remain widespread is the revenue that governments receive from tariffs. Novak is incorrect. Trade restrictions benefit specific groups, such as workers in the protected industries, but those benefits are most often less than the costs imposed on consumers and other industries as a whole.

(Module 17.1, LOS 17.b)

13. (B) Customs union.

Explanation

Economic unions and common markets remove all barriers to the movement of labor and capital among their members. Customs unions do not have this feature.

(Module 17.1, LOS 17.c)

14. (A) Domestic producers of the good.

Explanation

Quotas restrict the supply of imported goods, which increases the price domestically, benefiting domestic producers but harming domestic consumers. While some specific foreign producers may also benefit from the higher prices created by the quota if they receive the revenue transfer (due to higher prices received for all goods sold under the import license), foreign producers as a whole are likely to experience decreased sales in the country that imposes a quota.

(Module 17.1, LOS 17.b)

15. (C) domestic suppliers of goods protected by tariffs.

Explanation

Tariffs raise domestic prices, benefiting domestic suppliers.

(Module 17.1, LOS 17.b)

16. (C) industries competing with imported goods.

Explanation

Industries competing with imported goods may experience lower profit and employment due to international trade.

(Module 17.1, LOS 17.a)

17. (C) Trade with low-wage countries depresses wage rates in high-wage countries.

Explanation

Trade with low-wage countries does not in itself depress wage rates since productivity must be considered. The other arguments have some support among economists.

(Module 17.1, LOS 17.b)

18. (A) benefits the Japanese government and domestic producers.

Explanation

The Japanese government's action is an example of a tariff. A tariff is a tax imposed on imports and benefits the Japanese government because it collects the tariff. Domestic producers benefit because the reduction in the supply of imported goods means a higher domestic price. The other choices are incorrect. A tariff is considered less harmful than a quota (an import quantity limitation) because under a quota, the domestic government does not receive any funds as it would under a tariff (the foreign producers receive the revenue transfer). In the long run, trade restrictions do not protect the net number of jobs in the country. The number of jobs protected by import restrictions will be offset by jobs lost in the import/export industry. Import/export firms will be unable to sell the overpriced domestic products abroad or import and sell the lower priced restricted foreign-made product.

(Module 17.1, LOS 17.b)

19. (C) free trade area.

Explanation

A free trade area removes barriers to trade among its members but does not require any of its members to change their trade policies with non-members. A common market and a customs union both impose uniformity on trade rules with non-member nations, which could restrict a member's low-cost imports from a nation that is not a member.

(Module 17.1, LOS 17.c)

20. (C) increased revenue for the government.

Explanation

Import quotas and voluntary export restraints, unlike tariffs, do not necessarily generate tax revenue. The other choices describe effects that result from tariffs, quotas, and VERs.

(Module 17.1, LOS 17.b)

21. (B) Trucking companies.

Explanation

Tariffs on transportation equipment benefit the government in the form of tariff revenue, and benefit domestic producers and industry workers in the form of higher prices for transportation equipment. The users of transportation equipment, such as trucking companies, suffer from higher costs due to the higher prices of transportation equipment.

(Module 17.1, LOS 17.b)

22. (A) improve economic welfare for their members.

Explanation

The primary reason countries join regional trade agreements is to improve economic welfare by reducing or eliminating trade restrictions.

(Module 17.1, LOS 17.c)

23. (B) prohibits foreign firms from selling products below cost to gain market share.

Explanation

Firms dump their goods at a price lower than cost in order to drive out the competition. Once this is complete, they will be able to raise prices to much higher levels in order to gain abnormal profits. Of course, once prices are increased, new competitors may arise.

(Module 17.1, LOS 17.b)