

ECON 136 Midterm Exam #1
Oct. 12, 2016
Study Guide

This will be a closed-book exam in class; bring pencils, erasers, and a calculator (no cell phones as calculators). No Scantron forms.

The first part of the exam will consist of about 25 short-answer questions (multiple choice, fill in a blank, write a short phrase, draw a line on a graph, or do a short calculation). The second part will be an essay question. You will choose one topic for your response from among three.

Part 1 sample questions

Some of the multi-part questions here could be separate questions on the exam.

1. According to Ricardian trade theory, gains from trade are only possible for a country that enjoys an absolute advantage in producing at least one good. True or false?
2. Given a numbered graph showing straight-line production possibility frontiers for two countries (X and Y), both producing two products (A and B).
 - (a) Calculate each country's opportunity cost for each product.
 - (b) Indicate which country has an absolute advantage in producing each product.
 - (c) Indicate which country has a comparative advantage in producing each product.
 - (d) Give an example of terms of trade (trade price) that would provide a very small benefit to A and a large benefit to B.
3. Sketch a PPC that accounts for rising marginal costs of production.
4. Given a country's production combination (a point on its PPF) and given terms of trade, draw a TPF.
5. If two countries specialize in products that are only slightly different and each country enjoys economies of scale, how do both parties benefit from specialization and trade in these products (intra-industry trade)? Which of these is(are) true?

- Expanded production lowers each country's total production cost.
 - Expanded production lowers each country's marginal production cost.
 - Expanded production lowers each country's average production cost.
6. What does it mean when we say Country X is capital-abundant? Pick the best phrase.
- (a) Country X has a lot of capital.
 - (b) In Country X we find more invested capital than in Country Y.
 - (c) In Country X we find more invested capital per worker than in Country Y.
7. Suppose Country X is capital-abundant relative to Country Y and that product A is labor-intensive relative to product B. What will happen when trade opens up, according to Stolper-Samuelson theory? Mark all that apply.
- Country X will produce more of product A and trade some away for product B.
 - Country X will produce more of product B and trade some away for product A.
 - Short-term, a scarcity of capital will arise in Country A along with a surplus of labor.
 - Short-term, a scarcity of labor will arise in Country A along with a surplus of capital.
 - To correct the imbalance, there would be a tendency in Country A for wages to rise and returns to capital to fall.
 - To correct the imbalance, there would be a tendency in Country A for wages to fall and returns to capital to rise.
8. Which of these attributes would make a worker more economically mobile and therefore more valuable in the labor market? Mark all that apply.
- Willingness to move to another part of the country.
 - Willingness and ability to learn new skills.

- Holding a degree in economics versus holding a degree in art history.
9. Given side-by-side S/D curves like the ones for the US and Jamaica that were shown in class:
 - (a) Assuming no free trade, identify equilibrium prices and quantities in each country.
 - (b) Assuming free trade opens and neglecting transportation costs, identify the market-clearing price that arises in both countries. State the reason why this is the right price.
 - (c) Identify the quantity consumed in the US, and how much of this is from domestic sources and how much is imported.
 - (d) Identify the quantity produced in Jamaica, and how much of this is consumed domestically and how much is exported.
 - (e) Identify the highest trade price that would eliminate all US production.
 10. Continuing with the preceding question, a specified per-unit tariff is imposed. Identify the price received by Jamaican producers and the price paid (including tariff) by US consumers. State the reason why these are the right prices.
 11. In Ricardian trade theory, we first assumed constant marginal costs. Later we relaxed that assumption. Which of these statements are true? Mark all that are true.
 - (a) With constant marginal costs, terms of trade are usually determined by the strength of demand in each country.
 - (b) With constant marginal costs, a country's most profitable strategy is to produce only the product for which it enjoys a comparative advantage
 - (c) With rising marginal costs, a country's most profitable production combination is a mix of two products.
 12. With above-described tariff in place and areas marked *a* through *g* as in Fig. 8.4, identify the areas that represent:
 - (a) Loss of consumer surplus due to the tariff
 - (b) Gain of producer surplus

- (c) Deadweight loss
- (d) Tariff revenue

13. For the same graph, identify the quantities consumed
- (a) With no trade
 - (b) With free trade (domestic and foreign-sourced).
 - (c) With the tariff (domestic and foreign-sourced).

Answer in terms of the numbers or symbols given on the graph's axes. Also identify prices.

14. What happens to tariff revenue as the tariff rate rises, starting from zero (multiple choice)?
- (a) It remains constant.
 - (b) It remains proportional to the tariff rate.
 - (c) It rises at first, reaches a maximum, then declines to zero.
15. What happens to the world price when we relax the small country assumption when studying tariffs? Does it rise or fall? Explain.
16. Suppose a tariff is imposed on a product that has both domestic and foreign suppliers, and that the domestic supplier uses some imported parts which are also subject to a tariff. Given a set of numbers like those in Table 8.3, calculate the effective rate of protection for the domestic manufacturer. (Lesson: be careful about lobbying for tariffs on your product because they may inspire others to seek new tariffs on your foreign-sourced parts!)
17. Suppose a two-part tariff is imposed on pistachio nuts: 10% plus \$20 per ton. Calculate the total tariff due on a shipment of 2.5 tons of pistachios coming into the Port of Oakland, priced at \$450 per ton.
18. The general definition of deadweight loss is “a loss that is _____ .”
19. Name the three broad categories of production factors.
20. Suppose a protective tariff on shirts is initiated in Country A, which had been importing them from Country B. Among the following groups, who gains and who loses (short term)? Write “gain” or “lose” in the

boxes.

Consumers of shirts in Country A	
Consumers of shirts in Country B	
Owners of shirt factories and their employees in Country A	
Owners of shirt factories and their employees in Country B	
The private sector in Country A	
Country A as a whole, including its government	

21. Import quotas have most of the same economic impacts as tariffs. With a quota there is of course no tariff revenue; who gets the revenue that would otherwise go to the government?
22. Name one strategy the government could use to recoup all of the “lost” revenue when a quota is imposed instead of a tariff.
23. What has happened to tariff rates, generally speaking, in the last 75 years. Have they risen or fallen?
24. Which of the following are true of tariffs as revenue-raisers? Mark all that apply.
 - They make up at least 10% of current U.S. federal tax revenues.
 - They were the only significant source of federal revenue in 1790.
 - They are still significant revenue sources for governments in small under-developed countries.
 - Tariff revenues are not evident to consumers and therefore do not generate the degree of backlash that other taxes do, such as sales taxes.
25. “Dumping,” is thought to be an unfair trade practice. Which of these best describes dumping?
 - (a) Illegal disposition of waste material in landfills.
 - (b) Selling below the price asked by a foreign competitor.
 - (c) Selling below cost.
26. What are perpetrators of dumping allegedly trying to accomplish? Mark the best answer.

- (a) Increase their profits.
- (b) Promote national honor.
- (c) Drive their competitors out of the market.

27. Suppose a Chinese bicycle manufacturer has received subsidies from its government so that it can sell bicycles cheaply in the U.S.? Who gains and who loses, short-term? Write “gain” or “lose” in the boxes.

U.S. bicycle riders	
U.S. bicycle manufacturers	
Chinese bicycle manufacturers	
Chinese bicycle riders	(unclear)
Chinese taxpayers	

28. Following are some actions that the Chinese government could take to bolster its bicycle industry so as to increase bicycle exports. Mark each of these actions as “fair” or “unfair” according to the point of view of U.S. trade regulators.

Direct government subsidies of bicycle companies	
Encourage bicycle-riding in government-run schools	
Reduce regulations that hamper bicycle manufacturers	
Reduce corruption and promotion of the rule of law	
Provide a stable currency	

Is the

economic effect on the U.S. economy any different for “fair” policies than for “unfair” policies?

29. What is the purpose of economic sanctions?
- (a) Gain comparative advantage.
 - (b) Force the government of the target country to cease some hostile activity.
 - (c) Retaliate for dumping or other “unfair” trade practices.
30. What social groups bear the primary burden of economic sanctions in the target country?

- (a) The ruling elites
 - (b) The common people
 - (c) Tariff collectors
31. Name one country that is the subject of current economic sanctions and state the reason why they are being sanctioned.
32. Suppose trade barriers are proposed against a foreign supplier that uses “sweatshop” labor. What problems might be associated with such a proposal? Mark all that apply.
- (a) If successful, the trade barriers may deprive sweatshop workers of their least-bad alternative.
 - (b) The real motive of the backers of the trade barriers may be protection from foreign competition; the sweatshop argument may be a smokescreen.
 - (c) The trade barriers may inflict a lot of collateral damages: loss of consumer surplus, deadweight loss.

Part 2 sample questions

You will choose one of three questions to be answered in roughly a page of text. Some possibilities:

1. What is the stated intent of “infant industry” trade restrictions? Discuss three reasons why such protective measures often fail to achieve the desired results.
2. What is the stated intent of “cultural protection” trade restrictions? Who is being protected against whom? Who is negatively affected by these restrictions? Cast your discussion in terms of a particular country of your choice (e.g., Canada or China, but not the U.S.).
3. Why does Ford rip the seats out of the Transit vans that it imports from Turkey? What does this have to do with the “chicken tax?” Who imposed it and why?
4. Discuss the findings of Prof. Leontieff regarding U.S. exports. What did Heckscher-Ohlin theory predict and what did he find? Discuss at least two of the explanations for his findings, as discussed in class.

5. Discuss the “resource curse.” Under what circumstances does this arise? What goes wrong? Discuss two countries where “resource curse” has become especially apparent in recent years. Name one country that has huge per-capita resources but has escaped the resource curse.
6. Consider two situations:
 - A California manufacturer suffers a loss of business to a competitor in North Carolina.
 - A California manufacturer suffers a loss of business to a competitor in China.

Is there any real economic difference between the two situations? How is the federal government likely to respond to each of these situations, and why?