

MULTIPLE CHOICE

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|------|-------|-------|-------|
| 1. D | 6. C | 11. A | 16. D |
| 2. A | 7. C | 12. B | 17. A |
| 3. A | 8. D | 13. B | 18. C |
| 4. D | 9. D | 14. C | 19. D |
| 5. D | 10. B | 15. A | 20. C |

SHORT ANSWER QUESTIONS

Question 1

- (a)** Free trade is a situation where there are no artificial barriers to trade imposed by governments to shield domestic producers from foreign competitors.
- (b)** A nation may impose protectionist policies to protect its infant industries, so that they can compete with established industries while they are not yet large enough to achieve economies of scale. Protection also inhibits dumping, which occurs where foreign firms sell goods at prices lower than in their home market to establish market share.
- (c)** Free trade allows economies to specialise in the production of goods and services in which they have a comparative advantage. This leads to economies of scale in local production, and a more efficient allocation of resources both globally and domestically. This facilitates increased economic growth. The free flow of goods and services can facilitate the spread of technology across economies, and encourage innovation. Free trade also provides consumers with a greater variety of goods and services than could be produced domestically, at a lower price; which affords consumers the ability to achieve higher standards of living.
- (d)** Consumers will face higher prices as a result of the tariff, as it is a tax added directly to the price of the good. This will mean consumers will be able to purchase fewer goods and services at a given level of income. A tariff will lower foreign importers' market share, as their goods are artificially more expensive than domestic goods. Foreign importers will experience a decline in revenue unless they decide to shift their goods to a less protected market.

Question 2

- (a) Reduction in price = $\$12 - \10 (the reduction in equilibrium price)
= $\$2$
- (b) Increase in domestic production = $400 - 300$ (the increase in equilibrium quantity)
= 100
- (c) Subsidy = $\$14 - \10 (the vertical distance between the supply curves SS and S_1S_1)
= $\$4$
- (d) Subsidies allow producers to lower prices without harming their profits, which decreases inflationary pressures and increases domestic consumption. Also, since subsidies are an item of government expenditure, they are more likely to be subject to review and removed when they are no longer necessary.
- (e) Subsidies are used to protect inefficient industries in developed economies from foreign competition, ensuring they maintain their market share. Subsidies, such as those provided under the European Union's Common Agricultural Policy, slow global growth because they prevent the most efficient allocation of scarce resources. The use of subsidies also tends to divert income from developing nations which export protected goods to developed nations. Developing countries cannot compete at the low prices that subsidies allow. This reduces their share of global trade and decreases national income. Low incomes in developing nations inhibit global consumption and demand for imports, which further constrains the growth of the global economy.

Question 3

- (a) A trading bloc exists where a number of countries join together in a formal preferential trading agreement to the exclusion of other countries.
- (b) Australia is a member of the Asia Pacific Economic Cooperation (APEC) forum, but does not belong to the Association of South East Asian Nations (ASEAN).
- (c) Regional trade agreements have directed trade flows amongst members of the trading bloc to the exclusion of non-members. The European Union, for instance, has seen a rapid increase in intra-European trade due to its free trade agreement. At the same time, its high barriers to trade with non-members divert trade away from non-member nations. This may hinder free trade by dividing the global economy into separate trading zones.
- (d) Most recent attempts at multilateral trade liberalisation have come from the World Trade Organisation's Doha Round of negotiations. The Doha Round was launched in 2001, focusing on negotiating trade concessions for developing nations and reducing agricultural protection. However, these goals have been hindered by the USA and European Union's reluctance to reduce agricultural subsidies due to strong domestic opposition. The Doha Round also aims to increase flexibility for countries to impose environmental standards in trade negotiations. However, the Doha Round has passed its deadline without achieving its goal, perhaps indicating that for the moment, bilateral trade liberalisation is a more effective means to reduce barriers than the multilateral process.

SKILLS REVISION

Tariff Diagram

- (a) 6,000
- (b) 3,000
- (c) $5 \times 3,000 = \$15,000$
- (d) $5 \times (6,000 - 3,000) = \$15,000$
- (e) $10 - 5 = \$5$
- (f) 5,000
- (g) 4,000
- (h) $(10 - 5) \times (5,000 - 4,000) = \$5,000$
- (i) $10 \times 4,000 = \$40,000$
- (j) $5 \times (5,000 - 4,000) = \$5,000$

Quota Diagram

- (a) 8,000
- (b) 5,000
- (c) $150 \times 5,000 = \$750,000$
- (d) $150 \times (8,000 - 5,000) = \$450,000$
- (e) 1000 units*
- (f) 7,000
- (g) 6,000
- (h) $200 \times 6,000 = \$1,200,000$
- (i) $200 \times (7,000 - 6,000) = \$200,000$

*NB. (e) in the quota diagram should simply read "What is the size of the quota in this market?"