Review Questions for Midterm #2

The format for Midterm #2 will be similar to Midterm #1. On the midterm, some questions may come from, or be similar to, the following list of review/study questions.

1. Balance of Payments particulars:
   - What are the three broad accounts in the Balance of Payments?
   - Which account indicates a country’s trade position?

2. Discuss the following statement: “The Total balance-of-payments account must balance although subaccounts may not balance.” If the Current Account for a country is registering a surplus, what’s the most likely reason? What can be said about net financial flows into or out of the country?

3. In the Financial Account, what are some reasons private investors be watchful of changes in official reserves?

4. What does it mean for a currency to appreciate or depreciate against another currency? Who gains from currency depreciation and who gains from currency appreciation in the domestic economy? What are some ways by which a domestic company, selling products on the world market, can protect profits from exchange rate risk (i.e., the risk that a business’ operations or an investment’s value will be affected by changes in exchange rates)?

5. In the US economy, who is helped and who is hurt by a strong dollar and why? Who is helped and who is hurt by a weak dollar and why?

6. Why is significant arbitrage difficult in the Forex market?

7. From the perspective of a small country, a tariff is unambiguously bad for the country’s overall welfare. Why is this the case? How is it that a large country, when imposing a tariff, does not pay the entire cost of the tariff? In other words, what advantage does a large country have over a small country in terms of international trade? Use graph(s) as part of your answer.

8. Economists in general argue that although tariffs are bad trade policy, quotas are even worse. Why do economists believe quotas are worse than tariffs? What kinds of inefficiencies do quotas impose that tariffs do not?

9. Trade ministers from developing countries argue that the most egregious examples of trade barriers that restrict trade or alter world prices are those placed on agricultural products from either the US or the European Union (EU). Using either the US or the EU example describe what these trade ministers are complaining about. Use graph(s) as part of your answer.

10. Critics of Free Trade use domestic market failure as an argument against policies that lower barriers to trade (tariffs, quotas subsidies etc.). What are the main points of this argument? How do supporters of free trade policies counter this argument?

11. Although tariffs clearly limit trade, non-tariff barriers to trade are often seen as even worse. 1) Describe a couple of non-tariff barriers and why they are a growing problem in world trade. 2) Why do economists view them as distorting markets even more than tariffs?

12. What is “dumping” in terms of trade policy and why are economists skeptical of the arguments in favor of domestic policy against dumping? Use graph(s) as part of your answer.

13. Although subsidies to promote exports is often used by countries as part of national trade policy, economists view such a policy as being far worse than tariffs. Discuss. Use graph(s) as part of your answer.

14. Political economy models of trade attempt to measure trade policy preferences of voters through elections. Describe such a model and the dynamics and assumptions of the model.
15. Quotas, as one type of trade-policy mechanism, result in what economists call “quota rents”. What are quota rents and what do they mimic in standard microeconomic theory? Allocating quota licenses indicates which parties (producers, consumers, domestic entities, foreign entities) gain and who loses. What could a government do to mitigate the unequal economic distribution from quota licenses?