Learning Module 6: International Trade

Q.885 What is the *most likely* effect of export subsidies on the domestic country?

A. A decrease in prices and a decrease in consumer surplus.

B. An increase in prices and a decrease in consumer surplus.

C. An increase in prices and an increase in consumer surplus.

The correct answer is **B.**

Export subsidies are financial supports provided by the government to encourage domestic companies to export certain goods, aiming to increase their competitiveness in the global market. While this policy might bolster the domestic industry's presence internationally, it has a nuanced impact on the domestic market itself. Specifically, export subsidies tend to increase the domestic prices of the subsidized goods and decrease consumer surplus.

When the government provides export subsidies, domestic producers are incentivized to sell more of their products abroad. This redirection of goods towards foreign markets reduces the supply of these goods in the domestic market. According to the law of supply and demand, a decrease in supply, with demand remaining constant, leads to an increase in prices. Consequently, domestic consumers face higher prices for the goods that are now being exported in larger quantities. Furthermore, the increase in prices reduces consumer surplus, which is the difference between what consumers are willing to pay for a good or service and what they actually pay. In essence, consumers end up paying more for less, diminishing their overall welfare.

A is incorrect. This option suggests that export subsidies would lead to a decrease in prices and a decrease in consumer surplus. However, this overlooks the fundamental economic principle that a reduction in domestic supply due to increased exports leads to higher prices. While consumer surplus does decrease, it is not due to lower prices but rather the opposite.

C is incorrect. This option posits that export subsidies would lead to an increase in both prices and consumer surplus. Higher prices mean that consumers have to pay more for the same goods, reducing the difference between their willingness to pay and the actual price, thus decreasing consumer surplus.

CFA Level I, Economics, Learning Module 6: International Trade. LOS b: compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.887 In the Utopian Union, all members have established a common institution and economic policy. Furthermore, all barriers to import and export of goods and services have been removed between participating countries, and all barriers to the movement to labor and capital have also been removed. The Utopian Union is an example of:

A. A free trade area.

B. A monetary union.

C. An economic union.

The correct answer is **C.**

An Economic Union represents a significant level of integration among member countries, where not only are trade barriers removed, but there is also a concerted effort to harmonize economic policies, regulations, and to allow for the free movement of labor and capital. The Utopian Union, as described, fits this definition perfectly. By establishing common institutions and economic policies, and removing all barriers to the import and export of goods and services, as well as to the movement of labor and capital, the Utopian Union is ensuring that its member countries are not just cooperating on trade but are integrating their economies more deeply. This level of integration facilitates a more seamless economic environment that can lead to increased efficiency, economic growth, and stability across member states. The removal of barriers to the movement of labor and capital is particularly indicative of an economic union, as it allows for a more efficient allocation of resources across the union, potentially leading to higher levels of economic prosperity.

A is incorrect. A Free Trade Area is a type of trade bloc where member countries agree to eliminate tariffs, quotas, and preferences on most (if not all) goods and services traded between them. However, unlike an economic union, a free trade area does not require members to harmonize their economic policies or to allow for the free movement of labor and capital. Each member country maintains its own economic policies and regulations. Therefore, while a free trade area facilitates easier trade between member countries, it does not involve the deeper level of integration seen in an economic union, such as the Utopian Union, where there is a concerted effort to harmonize economic policies and regulations in addition to removing trade barriers.

B is incorrect. A Monetary Union involves countries agreeing to share a common currency and coordinate their monetary policies. While this represents a significant level of economic integration, it does not, by itself, constitute an economic union. A monetary union focuses primarily on monetary aspects, such as inflation rates, interest rates, and exchange rates, and does not necessarily include the harmonization of broader economic policies or the removal of barriers to the movement of labor and capital. In the case of the Utopian Union, the description goes beyond the characteristics of a monetary union by including not just common policies but also the removal of barriers to trade, labor, and capital, which are hallmarks of an economic union.

CFA Level I, Economics, Learning Module 6: International Trade. LOS c: Explain the motivations for and advantages of trading blocs, common markets, and economic unions.

Q.1557 Which of the following *most likely* exhibits the least level of integration among members?

A. Customs union.

B. Free trade area.

C. Economic union.

The correct answer is **B.**

In the context of economic integration among countries, a Free Trade Area (FTA) represents the level of integration where member countries agree to eliminate tariffs, quotas, and preferences on most (if not all) goods and services traded between them. However, unlike more integrated forms such as a customs union or an economic union, each member of a Free Trade Area maintains its own trade policies towards non-member countries. This means that within an FTA, countries can have different tariffs and regulations for the same product when it comes to trade with countries outside the FTA. This level of autonomy in external trade policies results in the least level of integration among the options provided, as it lacks mechanisms for deeper economic policy coordination or harmonization of external trade policies.

A is incorrect. A Customs Union represents a higher level of economic integration compared to a Free Trade Area. In addition to eliminating internal barriers to trade (as in an FTA), members of a Customs Union adopt a common external tariff (CET) on imports from non-member countries. This means that all members of a customs union agree on the tariffs and trade policies they will apply to goods and services coming from outside the union. This common external policy reduces the complexity of trade among member countries and with non-member countries, fostering a deeper level of economic integration than what is found in a Free Trade Area.

C is incorrect. An Economic Union embodies the highest level of economic integration among the options listed. It includes all the features of a customs union—free trade among members and a common external trade policy—and goes further by harmonizing members' economic policies. This can include coordination in areas such as monetary policy, fiscal policy, and social regulations. An Economic Union may also involve a common currency and deeper political integration. The coordination and unification of economic policies among member countries in an Economic Union facilitate a level of integration that significantly surpasses that of both a Free Trade Area and a Customs Union.

CFA Level I, Economics, Learning Module 6: International Trade. LOS c: explain the motivations for and advantages of trading blocs, common markets, and economic unions.

Q.3251 The introduction of an import quota on German manufactured automobiles would:

A. Generate the same revenue as a tariff for the country’s government.

B. Make the consumers of the importing country better off by sheltering their car manufacturers from foreign competition.

C. Limit the importation of cars and permit the German auto importers to fully offset the expected loss in sales by raising the prices of their cars.

The correct answer is **C.**

An import quota on German manufactured automobiles would limit the number of cars that can be imported, effectively reducing the supply of German cars in the importing country. This scarcity can enable German auto importers to increase the prices of their cars, potentially offsetting the expected loss in sales volume due to the quota. Import quotas are a form of trade restriction that limits the quantity of goods that can be imported into a country. By imposing a quota on German cars, the importing country's government aims to protect its domestic auto industry from foreign competition. However, this protection comes at a cost to consumers, who face higher prices and fewer choices.

A is incorrect. An import quota does not generate revenue for the government in the same way a tariff does. A tariff is a tax imposed on imported goods, which directly generates revenue for the government when the goods are imported. In contrast, an import quota restricts the quantity of goods that can be imported without directly generating tax revenue. The primary financial benefit of an import quota may accrue to domestic producers who face reduced competition, or to foreign exporters who can raise prices due to limited supply, but it does not create direct government revenue like a tariff.

B is incorrect. The restriction on imports reduces the supply of foreign cars, leading to higher prices for both imported and domestically produced automobiles. The reduced competition may also lead to a decrease in the quality of domestically produced cars. Consumers face higher costs and have fewer choices, which negatively impacts their welfare. Therefore, while an import quota may benefit domestic car manufacturers by reducing foreign competition, it does not make consumers better off.

CFA Level I, Economics, Learning Module 6: International Trade. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4777 Which of the following *most likely* represents a benefit of international trade?

A. The imposition of tariffs to reduce foreign competition.

B. An increase in domestic employment due to protected industries.

C. A country importing goods at a lower cost than it would incur if it produced them domestically.

The correct answer is **C.**

Gains from exchange in international trade involve scenarios where trade enables countries to enhance their consumption and production efficiency. Importing goods at a lower cost than producing them domestically allows a country to allocate resources more efficiently, thereby increasing its overall welfare. This advantage stems from avoiding high domestic production costs and utilizing cheaper foreign alternatives, enhancing consumer surplus and economic efficiency.

A is incorrect. The imposition of tariffs is a trade barrier that restricts imports to protect domestic industries, which generally decreases overall trade efficiency. Tariffs lead to higher consumer prices and can provoke retaliatory measures from trade partners, often reducing the potential gains from trade.

B is incorrect. Increasing domestic employment through protected industries involves protective measures like subsidies or tariffs, which may create jobs in the short term but do not represent gains from trade. These measures often lead to inefficiencies by supporting industries that might otherwise not be competitive on their own merits.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS a: Describe the benefits and costs of international trade.

Q.4778 Which of the following is *most likely* the primary reason that increased competition from international trade forces domestic firms to become more efficient?

A. Foreign firms introduce new government regulations.

B. Foreign firms provide capital investment in domestic markets.

C. Foreign firms offer lower prices, compelling domestic firms to innovate and reduce costs.

The correct answer is **C.**

The presence of foreign competitors in a market usually leads to increased competition, which drives down prices and forces domestic firms to enhance their operational efficiency. To survive and maintain market share, domestic firms must innovate, improve product quality, and reduce production costs. This dynamic is crucial for maintaining competitiveness in a global market where consumers have access to a variety of choices at different price points.

A is incorrect. Foreign firms do not have the authority to introduce new regulations in a domestic market. Regulatory changes are typically the domain of governmental or regulatory bodies within the country, and although these can affect how firms operate, they are not a direct result of competitive pressures.

B is incorrect. While foreign capital investment can enhance economic capacity, it does not directly drive domestic firms to improve efficiency. Capital investment can lead to expanded operations but doesn't inherently require firms to enhance productivity or innovation.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS a: Describe the benefits and costs of international trade.

Q.4779 How do tariffs *primarily* aim to protect domestic industries?

A. By reducing trade deficits.

B. By increasing consumer surplus.

C. By imposing additional costs on imports.

The correct answer is **C.**

Tariffs impose additional costs on imports, making them more expensive compared to domestic goods. This protects domestic industries by reducing foreign competition and potentially increasing domestic production and employment.

A is incorrect. While tariffs can impact trade deficits, their primary aim is to protect domestic industries from foreign competition. Tariffs make imported goods more expensive, giving domestic producers a competitive advantage.

B is incorrect. Tariffs typically lead to a decrease in consumer surplus, as they can result in higher prices for imported goods. Consumers may face higher prices and reduced choice due to tariffs.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4780 What is the *main* purpose of domestic content provisions in trade agreements?

A. To promote free trade.

B. To reduce consumer surplus.

C. To ensure that a certain percentage of a product's value is of domestic origin.

The correct answer is **C.**

Domestic content provisions stipulate that a certain percentage of the value added or components used in production should be of domestic origin. This is aimed at promoting domestic production and supporting domestic industries.

A is incorrect. Domestic content provisions are a form of trade restriction aimed at protecting domestic industries, rather than promoting free trade.

B is incorrect. Domestic content provisions are not aimed at reducing consumer surplus, but rather at promoting domestic production.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Tarde. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4781 How does a tariff imposed by a large importing country *most likely* affect the terms of trade?

A. It has no effect on the terms of trade.

B. It increases the world market price of the imported good.

C. It leads to a redistribution of income from the exporting country to the importing country.

The correct answer is **C.**

A tariff imposed by a large importing country forces exporters to reduce their prices to retain market share in the importing country. This reduction in the export price means that the terms of trade—the ratio of export prices to import prices—improve for the importing country. Essentially, the importing country can now obtain the same quantity of goods for a lower price, resulting in a redistribution of income from the exporting country to the importing country.

A is incorrect. A tariff does affect the terms of trade by changing the relative prices of goods between countries. The imposition of a tariff by a large importer can influence the global market by forcing exporters to lower their prices.

B is incorrect. While a tariff increases the domestic price of the imported good, it does not necessarily increase the world market price. In fact, the pressure to retain market share often results in exporters lowering their prices, thus reducing the world market price of the good.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4782 How do export subsidies *most likely affect the domestic market of the exporting country?*

A. They decrease prices in the domestic market.

B. They increase domestic production and exports.

C. They encourage trade that is consistent with comparative advantage.

The correct answer is ***B.***

Export subsidies motivate exporters to prioritize selling in the export market due to the subsidy, leading to increased domestic production and exports. This can potentially lead to higher prices in the domestic market.

A is incorrect. *Export subsidies can lead to higher prices in the domestic market, as exporters prioritize selling in the higher-priced export market.*

C is incorrect. *Export subsidies may distort trade away from comparative advantage, as they incentivize production and trade that may not be competitive without the subsidy.*

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4783 Which of the following is a *key* difference between tariffs and quotas?

A. Tariffs increase consumer surplus, while quotas decrease consumer surplus.

B. Tariffs are imposed by the exporting country, while quotas are imposed by the importing country.

C. Tariffs generate revenue for the government, while quotas may lead to quota rents for foreign producers.

The correct answer is **C.**

Tariffs are taxes imposed on imports, and the revenue generated goes to the government. Quotas restrict the quantity of imports, potentially allowing foreign producers to raise prices and earn greater profits (quota rents).

A is incorrect. Both tariffs and quotas can lead to a decrease in consumer surplus, as they restrict the availability of goods and can lead to higher prices for consumers.

B is incorrect. Tariffs and quotas are both trade restrictions imposed by the importing country.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4784 What is the *primary* objective of a voluntary export restraint (VER) imposed by an exporting country?

A. To capture quota rent.

B. To boost export activities.

C. To increase consumer surplus in the importing country.

The correct answer is **A.**

A VER allows the exporting country to limit its exports and capture the quota rent that would otherwise go to the importing country. This benefits the exporting country's producers. The importing country may face higher prices and reduced choice, potentially leading to a decrease in consumer surplus.

B is incorrect. VERs are imposed to restrict export activities to a specific number of units, rather than boosting them. VERs are a form of trade restriction, not an export promotion measure.

C is incorrect. VERs typically lead to a decrease in consumer surplus in the importing country, as they restrict the availability of goods and can lead to higher prices for consumers.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS b: Compare types of trade restrictions, such as tariffs, quotas, and export subsidies, and their economic implications.

Q.4800 Which of the following regional integration agreements involves the highest level of economic integration among member countries?

A. Free trade area.

B. Customs union.

C. Economic union.

The correct answer is **C.**

An Economic Union embodies the highest level of economic integration among the options listed. It includes all the features of a customs union—free trade among members and a common external trade policy—and goes further by harmonizing members' economic policies. This can include coordination in areas such as monetary policy, fiscal policy, and social regulations. An Economic Union may also involve a common currency and deeper political integration, in which case it will be called a monetary union. The coordination and unification of economic policies among member countries in an Economic Union facilitate a level of integration that significantly surpasses that of both a Free Trade Area and a Customs Union.

A and B are incorrect. Of the listed options, an economic union has the highest level of integration. A customs union has a higher level of integration than a free trade area but lacks the free movement of factors of production and coordination of economic policies among its members.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS c: Explain the motivations for and advantages of trading blocs, common markets, and economic unions.

Q.4809 Which of the following statements about Free Trade Areas (FTA) is true?

A. FTAs require a common currency among member countries.

B. FTAs have common trade barriers against countries that are not members.

C. FTAs allow free movement of goods and services among members but maintain individual trade policies against non-members.

The correct answer is **C.**

Free Trade Areas (FTAs) allow free movement of goods and services among members but maintain individual trade policies against non-members. This means that each member of an FTA can have different tariffs and regulations for the same product when it comes to trade with countries outside the FTA.

A is incorrect. The trading bloc that requires a common currency among member countries is the Monetary Union.

B is incorrect. In a Free Trade Area (FTA), each member retains its trade policies against non-members. The trading blocs that have trade barriers against countries that are not members are custom unions, common markets, and economic unions.

CFA Level 1, Volume 1, Topic 2 - Economics, Learning Module 6 - International Trade. LOS c: Explain the motivations for and advantages of trading blocs, common markets, and economic unions.

Q.4813 Trade diversion *most likely* occurs in a customs union when:

A. Member countries increase imports from each other.

B. Member countries increase imports from non-member countries.

C. Member countries decrease imports from non-member countries.

The correct answer is **C.**

Trade diversion occurs when lower-cost imports from non-member countries are replaced with higher-cost imports from member countries. This can happen in a customs union when member countries impose a common external tariff on imports from non-member countries, leading to a shift in trade patterns towards higher-cost member countries.

A and B are incorrect. Trade diversion occurs when higher-cost imports from member countries replace lower-cost imports from non-member countries. The higher-cost imports from member countries become "cheaper" due to the elimination of tariffs from member countries.

Q.4814 Which of the following is *most likely* a potential drawback of regional integration?

A. Technology transfers.

B. Economies of scale from larger market sizes.

C. Displacement of workers in inefficient firms due to import competition.

The correct answer is **C.**

One potential drawback of regional integration is that import competition can lead to the displacement of workers in inefficient firms, as these firms may struggle to compete with lower-cost imports from other member countries. This can result in temporary unemployment and adjustment costs for affected workers.

A and B are incorrect. Technology transfers and economies of scale from larger market sizes are advantages of regional integration.
