

Questions 5-9 refer to the following information:

| Output | Good X | Good Y |
|-----------|--------|--------|
| Country A | 40 | 80 |
| Country B | 60 | 90 |

5. Country A has the absolute advantage over country B in the production of:
 - a. good X only.
 - b. good Y only.
 - c. both goods X and Y.
 - d. neither good X nor good Y.
6. Country A has a comparative advantage over country B in the production of:
 - a. good X.
 - b. good Y.
 - c. both goods X and Y.
 - d. neither good X nor good Y.
7. To gain from trade, country B should specialise in the production of:
 - a. good X only.
 - b. good Y only.
 - c. both goods X and Y.
 - d. neither good X nor good Y.
8. The opportunity cost of producing each unit of good Y in country A is:
 - a. 0.5 units of good X.
 - b. 2 units of good X.
 - c. 4 units of good X.
 - d. 40 units of good X.
9. For both countries to gain from trading, the terms of trade must lie between:
 - a. one unit of good X would sell between 1 and 2 units of good Y.
 - b. one unit of good X would sell between 0.5 and 1 unit of good Y.
 - c. one unit of good X would sell between 1.5 and 2 units of good Y.
 - d. one unit of good X would sell between 8 and 9 units of good Y.
10. If a country specialises in producing goods it has a comparative advantage in and then undertakes trade, then this country is likely to be:
 - a. producing inside its production possibility frontier.
 - b. consuming inside its production possibility frontier.
 - c. consuming outside its production possibility frontier.
 - d. producing outside its production possibility frontier.
11. Who gains from international trade?
 - a. Only the exporting nation.
 - b. Only the importing nation.
 - c. Both the importing and the exporting nations.
 - d. Neither the importing nor the exporting nations.
12. How can a domestic producer determine whether or not it has a comparative advantage in the production of a good or service?
 - a. It cannot.
 - b. By comparing the price it receives to the prices of other domestic producers.
 - c. By comparing the price it receives to the world price.
 - d. By comparing the quantity it produces to the quantity produced in the world.

Working with models

A. The production possibilities for two countries A land and B land are shown below.

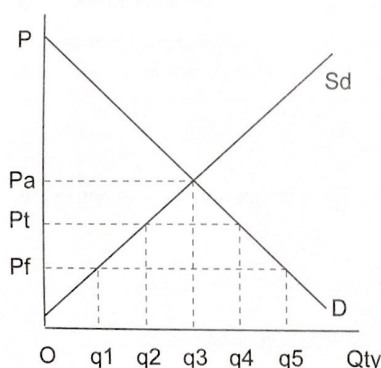
| | Apples | or | Oranges |
|--------|--------|----|---------|
| A land | 6000 | or | 6000 |
| B land | 2000 | or | 4000 |

- Construct a production possibility curve for each country .
- Which country has the absolute advantage in producing apples?
- Which country has the absolute advantage in producing oranges?
- What is the opportunity cost of producing apples in both countries?
- What is the opportunity cost of producing oranges in both countries?
- Who has the comparative advantage in producing apples?
- Who has the comparative advantage in producing oranges?
- If both countries decide to trade, which country will export apples and which country will export oranges?
- If both countries decide to trade, within what range will the terms of trade lie?
- Complete the missing cells in the table.
- As a result of specialisation and trade, these two countries are better off because they are consuming more apples and oranges than before trade - apple production has increased by _____ units while orange production increased by _____ units.

| Before specialisation | Apples | Oranges |
|--|--------|---------|
| Country A | 4500 | .... |
| Country B | .... | 2000 |
| Total | 5500 | 3500 |
| After specialisation | | |
| Country A | ..... | .... |
| Country B | ..... | .... |
| Total | ..... | .... |
| After trade (assume terms of trade: 1 apple = 1.5 oranges) | | |
| Country A | 4800 | .... |
| Country B | 1200 | .... |
| Total | 6000 | 4000 |

B. Use the tariff diagram below to complete the missing values in the table.

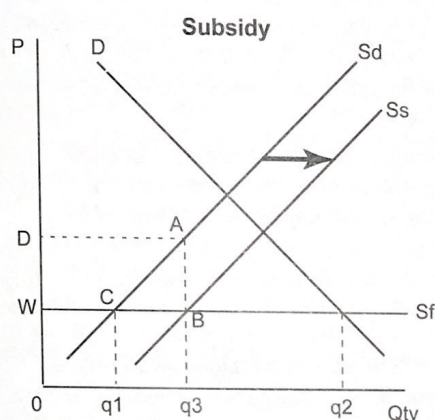
- Who benefits from the tariff?
- Who loses from the tariff?
- Why are tariffs considered inefficient?



| | With tariff | Tariff removed |
|-------------------|-------------|----------------|
| Price | | |
| Quantity consumed | | |
| Quantity produced | | |
| Imports | | |
| Consumer surplus | | |
| Producer surplus | | |
| Govt revenue | | |
| Deadweight loss | | |

C. Refer to the subsidy diagram below to complete the missing values.

1. After the subsidy is paid to domestic producers does consumer surplus increase, decrease or stay the same?
2. After the subsidy, does producer surplus increase, decrease or stay the same?
3. What is the cost of the subsidy?
4. What is the deadweight loss associated with the subsidy?



| | Before subsidy | After subsidy removed |
|-------------------|----------------|-----------------------|
| Price | | |
| Quantity consumed | | |
| Quantity produced | | |
| Imports | | |
| Deadweight loss | | |

Worksheet - protection & trade liberalisation

1. Define protection. What are the three broad types of protection?
2. Does protection result in a net gain or a net loss for society?
3. What is a tariff? Draw a diagram to help explain the effects of a tariff. Show that a tariff results in higher prices and lower consumption.
4. Which groups gain from tariffs and which groups lose?
5. Draw a diagram to illustrate the effects of a subsidy. How does a subsidy differ from a tariff?
6. Explain why a subsidy results in a deadweight loss.
7. List and explain three arguments for protection.
8. Outline four arguments for trade liberalisation.
9. What is the aim of the WTO? Explain the 'most favoured nation' principle?
10. What is a regional trade agreement?
11. What is the purpose of a 'trade bloc'?
12. Distinguish between trade creation and trade diversion.
13. Why are bilateral trade agreements more common than multilateral agreements?

Articles to review

The questions below refer to article 1 (see over)

1. Define a free trade agreement.
2. How do Australian exporters gain from an FTA?
3. How do Australian consumers gain from an FTA?
4. Explain how an FTA can contribute to higher GDP growth.

Article 1 Free Trade Agreements

Across the globe, there is an expanding network of free trade agreements (FTAs). High-quality, comprehensive free trade agreements can play an important role in supporting global trade liberalisation and are explicitly allowed for under the World Trade Organization (WTO) rules. An FTA is an international treaty which removes barriers to trade and facilitates stronger trade and commercial ties, contributing to increased economic integration between participating countries. FTAs can cover entire regions with multiple participants or link just two economies. FTAs open up opportunities for Australian exporters and investors to expand their businesses into key overseas markets. FTAs can improve market access across all areas of trade and help to maintain and stimulate the competitiveness of Australian firms. This benefits Australian consumers through access to an increased range of better value goods and services.

FTAs offer preferential treatment in partner countries for Australian goods, in the form of tariff elimination or reduction. For businesses already exporting goods to an FTA partner country, this increases the competitiveness of their products in those markets, especially compared to competitors from countries that do not receive preferential treatment under an FTA. Lower tariffs or other preferential treatment can be a good incentive for Australian businesses to consider exporting to a new market for the first time or expanding a product range. Foreign businesses may be more interested in importing Australian products as a result of an FTA coming into force. FTAs can increase Australia's productivity and contribute to higher GDP growth by allowing domestic businesses access to cheaper inputs, introducing new technologies, and fostering competition and innovation. (Source: DFAT)

Article 2 China imposes massive tariffs on Australian wine

On March 26, 2021, China's government imposed tariffs of 116–218% on bottled Australian wine imports through to 2026. This effectively shut the doors on what was Australia's largest wine export market. Why did this happen? China believed that Australian exporters were selling wine for less than it cost to produce. The selling of products by exporters below cost or for less overseas than in their domestic market is viewed as dumping. No other country had accused Australia of dumping or subsidising its wine industry.

The Australian wine industry relies heavily on exports, shipping 60% its production overseas. Australian wine sales in China had grown rapidly and by 2019, China had become Australia's first AUD \$1 billion a year wine market. China accounted for 40% of all Australian wine exports.

Both Australian wine producers and Chinese importers reject claims that Australian wine is being "dumped" below cost in China. Instead many believe that China is using the 'dumping' allegation in order to protect its own domestic wine industry from losing market share to Australia. Previously, under the China-Australia Free Trade Agreement (ChAFTA), there were zero tariffs on Australian wine. This compares to tariffs of more than 80 per cent on American wine. This helps explain why Australian wines have captured the Chinese market. By the end of 2021, a year after the first round of tariffs, Australian wine exports to mainland China had decreased by 97% in value.

Questions for article 2

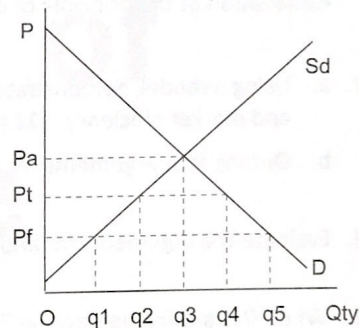
1. Why did China impose tariffs on Australian wine?
2. What is the economic definition of 'dumping'?
3. Why is dumping viewed as harmful?
4. Analyse the effects of China imposing a tariff on Australian wine exporters and on Chinese wine consumers.

Multiple choice 2 - protection & trade liberalisation

1. The purpose of protection is to
 - a. increase income for the whole economy.
 - b. increase income for the protected industry.
 - c. increase efficiency in the protected industry.
 - d. increase the volume of trade.
2. A tariff protects domestic industry by
 - a. raising the price of imported goods.
 - b. lowering the cost of domestically produced goods.
 - c. raising government revenue which is then returned to the protected industry.
 - d. increasing productivity in the protected industry.
3. Protection results in a
 - a. more efficient allocation of resources and a lower level of national income.
 - b. less efficient allocation of resources and a higher level of national income.
 - c. less efficient allocation of resources and a lower level of national income.
 - d. more efficient allocation of resources and a higher level of national income.

Questions 4-5 are based on the diagram at right. A tariff of $P_f P_t$ is applied to the good.

4. The tariff boosts domestic production by
 - a. $q_1 q_2$.
 - b. $q_1 q_3$.
 - c. $q_2 q_4$.
 - d. $q_3 q_4$.
5. If the tariff was removed then consumers would pay _____ and imports would equal _____.
 - a. P_a ; $q_2 q_4$.
 - b. P_f ; $q_1 q_5$.
 - c. P_f ; $q_2 q_4$.
 - d. P_f ; $q_1 q_5$.



6. The effect of a tariff is to
 - a. increase consumer surplus and decrease producer surplus.
 - b. increase producer surplus and decrease consumer surplus.
 - c. increase consumer surplus and increase producer surplus.
 - d. decrease consumer surplus and decrease producer surplus.
7. A subsidy paid to an import-competing domestic industry will
 - a. raise the world price of the product.
 - b. result in lower average living standards for society.
 - c. improve the efficiency of the domestic industry.
 - d. shift the demand curve for the product to the right.
8. A country imposes a tariff to improve the welfare of
 - a. some domestic producers at the expense of other domestic producers.
 - b. some domestic producers at no expense of other domestic producers.
 - c. domestic consumers.
 - d. domestic exporters.
9. A subsidy paid to an import-competing domestic industry will
 - a. decrease producer surplus and increase consumer surplus.
 - b. increase producer surplus and decrease consumer surplus.
 - c. increase producer surplus but create a deadweight loss.
 - d. increase producer surplus and increase government revenue.

10. A likely effect of the imposition of tariffs on steel imports by the United States is
 - a. lower costs for American consumers when they purchase domestically-produced goods.
 - b. greater international competitiveness of the American steel industry.
 - c. a net increase in employment in American manufacturing industries.
 - d. reduced exports for other American producers, who face higher costs.
11. Which of the following chain of events occurs when a tariff is imposed on a good?
 - a. Domestic prices rise, shifting the domestic supply curve rightward.
 - b. Domestic prices fall, shifting the demand curve right, and consumers buy more of the good.
 - c. Domestic prices fall, decreasing the domestic quantity supplied and increasing the quantity demanded.
 - d. Domestic prices rise, decreasing the quantity demanded and increasing the domestic quantity supplied.

Extended responses

Answer each of the following questions in about 2-3 pages of normal writing. Use economic models and examples where appropriate. Each question is worth 20 marks.

1. Using a model, demonstrate and explain the gains from specialisation and trade. Include an explanation of the principle of comparative advantage.
2. a. Using a model, demonstrate and explain how either a tariff or a subsidy affects trade and market efficiency. [12 marks]
b. Outline four arguments for protection. [8 marks]
3. Evaluate the arguments for and against trade protection. [20 marks]
4. When Donald Trump became President of the United States in 2018 he announced a range of trade protection measures. His arguments for this action were to improve US national security, stop importers 'dumping' products in the US market, increase US employment, and reduce the US trade deficit.

Evaluate the economic validity of the President's arguments for trade protection.
[20 marks]