MID TERM I - Practice

I. Short Answer Questions (community stands for either EEC, EC, or EU)

1. The sizes of the original 6 members of the European Coal and Steel Community were very different. Did the Schumann Plan address the issue? What was the principle involved?

2. Why was the UK reluctant to be involved in the Common Agricultural Policy in the early days of the Community?

3. Subsidiarity means that whenever possible it is better for Brussels to delegate to the member states. Which form of legislation initiated by the commission best meet this principle? Explain.

4. The EU's revenues consist of revenues generated by the common commercial policy, revenues from value added taxes and a certain proportion of GDP: which of these are considered as own resources and which are contributions by the member states?

5. The EU is often accused of dumping: what is the basic symptom of dumping (i.e. how does the ITC define dumping)?

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1 The American agency that investigates possible dumping.
6. What is the difference between a free trade area and a customs union?

7. Article 86 makes the abuse of a dominant position illegal. However the Competition Policy of the EU also deals with other forms of anti-competitive behavior. What kind of anti-competitive practices are forbidden by Article 85?

8. In which specific circumstances does the EU (and the US) use the right to impose countervailing duties (legal with WTO)?

9. Border taxes and subsidies: explain what happens to the VAT when the EU export goods to the rest of the world.

10. The subsidies to agriculture were distributed under the auspices of the Guarantee Fund (compulsory expenditures in the budget) and of the Guidance Fund (non-compulsory expenditures in the budget): what was the goal and the impact of the Guidance fund on European agriculture.
II. **Theory – Customs Union with 2 large countries**

Assumptions: 2 large countries A and B join into a CU that is small vis-à-vis the rest of the world. B produces good X at lower price \( P_b \) than A does \( P_a \) – these are autarky prices. The world price \( P_w \) is even lower.

Before
- A sets a specific tariff \( T_a \) and imports from the rest of the world as \( P_w < P_b \)
- B sets a prohibitive tariff \( T_b \) against the rest of the world

After
- A and B (the CU) set a tariff \( T_{cu} \) (some average of \( T_a \) and \( T_b \)) above the world price \( P_w \) that totally protects the CU.

Show on the graph below:
- the customs union price \( P_{cu} \)
- the tariff ridden customs union price \( P_w + T_{cu} \)

Carry out the welfare analysis of joining a CU for country A and for country B (the gains and the losses for each country by shading the relevant areas and naming them)
III. Problems

Suppose that the autarky price of commodity X is $10 in Nation A, $8 in Nation B, and $6 in Nation C. Assume also that Nation A is too small to affect prices in Nation B or in Nation C by trading (i.e. it faces infinitely elastic supplies from these two countries). A is a price taker vis-à-vis B and C while B is a price taker vis-à-vis C.

a. Initially, Nation A imposes a non-discriminatory (i.e. the same tariff applies whatever the origin of the commodity imported) ad valorem tariff of 50% (i.e. the tariff is equal to 50% of the foreign price) on the price of imports of commodity X.

i. What is Nation A’s domestic prices for X

Produced in A
Imported from B
Imported from C
Free trade price

ii. Will Nation A produce commodity X domestically? 
or will it import it from B? 
or will it import it from C?

b. Subsequently, Nation A and Nation B form a customs union. The common tariff rate on non-members remains at 50% ad valorem.

i. What is Nation A’s domestic prices for X

Produced in A
Imported from B
Imported from C
Free trade price

ii. Will Nation A produce commodity X domestically? 
or will it import it from B? 
or will it import it from C?
c. Is the customs union that Nation A and Nation B formed

trade creating only? _____
or trade diverting only? _____
or both? _____
or neither? _____

Explain from the point of view of Nation A.

d. Draw on the partial equilibrium graph showing the market for commodity X in Nation A whatever is needed to illustrate the situation described in sections a, b, and c. Specifically, show all the various foreign supplies (with or without tariff) and the various prices. Then show the welfare change(s) from situation a. to situation b. using shaded area(s) and naming these area(s) with letters. Explain the graph with a short comment.

e. Now try to calculate the value of domestic production and of domestic consumption in A, the value of the imports from its partner and the value of the welfare effects illustrated above using the following information: the domestic supply in A is $S = P + 90$ and the domestic demand in A is

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2 Treat the effects of trade expansion as if they were part of total trade creation and base your conclusions on the change in domestic prices in Nation A from the situation described in a. to that described in b.
D = -P + 110.