

File: c10; Chapter 10: Economic Integration: Customs Unions and Free Trade Areas

Multiple Choice

1. Which of the following statements is correct?
 - a. In a customs union, member nations apply a uniform external tariff
 - b. in a free-trade area, member nations harmonize their monetary and fiscal policies
 - c. within a customs union there is unrestricted factor movement
 - d. a customs union is a higher form of economic integration than a common market

2. A customs union that allows for the free movement of labor and capital among its member nations is called a:
 - a. preferential trade arrangement
 - b. free-trade area
 - c. common market
 - d. all of the above

3. A trade-creating customs union is one where:
 - a. lower-cost imports from outside the customs union are replaced by higher-cost imports from a union member
 - b. some domestic production in a member nation is replaced by lower-cost imports from another member nation
 - c. trade among members increases but trade with nonmembers decreases
 - d. trade among members decreases while trade with nonmembers increases

4. A trade-diverting customs union:
 - a. increases trade among union members and with nonmember nations
 - b. reduces trade among union members and with nonmember nations
 - c. increases trade among members but reduces trade with non-members
 - d. reduces trade among union members but increases it with nonmembers

5. A trade-diverting customs union results in:
 - a. trade diversion only
 - b. trade creation only
 - c. both trade creation and trade diversion
 - d. we cannot say

6. The formation of a trade-creating customs union where all economic resources of member nations are fully employed before and after the formation of the customs union leads to an:

- a. increase in the welfare of member and nonmember nations
 - b. increase in the welfare of member nations only
 - c. increase in the welfare of nonmember nations only
 - d. increase or decrease in the welfare of member and nonmember nations
7. A trade-diverting customs union:
- a. increases the welfare of member and nonmember nations
 - b. reduces the welfare of member and nonmember nations
 - c. increases the welfare of member nations but reduces that of nonmembers
 - d. reduces the welfare of nonmembers and may increase or reduce that of members
8. A trade-diverting customs union is more likely to lead to trade creation:
- a. the lower are the pre-union trade barriers of the member countries
 - b. the lower are the customs union's barriers on trade with the rest of the world
 - c. the smaller is the number of countries forming the customs union and the smaller their size
 - d. the more complementary rather than competitive are the economies of the nations forming the customs union
9. The theory of customs union is a special case of the theory of:
- a. effective protection
 - b. the second best
 - c. the product cycle
 - d. comparative advantage
10. Which is not a dynamic benefit from the formation of a customs union?
- a. increased competition
 - b. economies of scale
 - c. stimulus to investment
 - d. trade creation
11. The formation of the EU resulted in:
- a. trade creation in industrial and agricultural products
 - b. trade diversion in industrial and agricultural products
 - c. trade creation in industrial products and trade diversion in agricultural products
 - d. trade diversion in industrial products and trade creation in agricultural products
12. The benefit that the United States is likely to receive from NAFTA:
- a. increasing competition in product and resource markets
 - b. greater technical innovation
 - c. improvements in its terms of trade

d. all of the above

13. The benefit that Mexico is likely to receive from NAFTA:

- a. greater export-led growth
- b. encouraging the return of flight capital
- c. more rapid structural change
- d. all of the above

14. Which is a stumbling block to successful economic integration among groups of developing nations?

- a. benefits are not evenly distributed among nations
- b. many developing nations are not willing to relinquish part of their newly-acquired sovereignty to a supranational community body, as required for successful economic integration
- c. the complementary nature of their economies and competition for the same world markets for their agricultural exports
- d. all of the above

15. The formation of a free trade area among the countries of Eastern Europe is advocated in order to:

- a. restore trade trading
- b. retain the traditional trade links that can be justified on market principles
- c. reduce the need for structural change
- d. none of the above

16. The North American Free Trade Agreement (NAFTA) is best defined as a

- a. free trade area
- b. customs union
- c. preferential trade arrangement
- d. economic union

17. One potential outcome from the formation of a regional trade agreement is

- a. trade creation
- b. trade diversion
- c. economies of scale
- d. all of the above

18. The European Union currently has

- a. 6 members
- b. 12 members
- c. 15 members

d. 27 members

19. A customs union is more like to lead to trade creation and increased welfare under the following condition

- a. lower pre-union trade barriers
- b. lower trade barriers with the rest of the world
- c. complementary economies
- d. a smaller number of members

20. The following country is not a member of the European Union

- a. Switzerland
- b. Sweden
- c. Ireland
- d. Greece

Short Answer

21. What is trade diversion?

22. What is the theory of second best?

23. Discuss the potential dynamic welfare gains that can result from the formation of a customs union.

24. Discuss the conditions which are more likely to lead to increased welfare with the formation of a customs union.

