

Answers to Selected Problems

Chapter 1

6. a. Consumer demand theory predicts that when the price of a commodity rises (*cet. par.*), the quantity demanded of the commodity declines.
b. When the price of imports rises to domestic consumers, the quantity demanded of exports can be expected to decline (if everything else remains constant).
7. a. A government can reduce a budget deficit by reducing government expenditures and/or increasing taxes.
b. A nation can reduce or eliminate a balance-of-payments deficit by taxing imports and/or subsidizing exports, by borrowing more abroad or lending less to other nations, and by reducing the level of its national income.
10. International trade results in lower prices for consumers but harms domestic producers of products which compete with imports. Often those domestic producers that stand to lose a great deal from imports band together to pressure the government to restrict imports.

Since consumers are many and unorganized and each individually stands to lose only very little from the import restrictions, governments often give in to the demands of producers and impose

some import restrictions. These topics are discussed in detail in Chapter 9.

Chapter 2

2. In case A, the United States has a comparative advantage in wheat and the United Kingdom in cloth.
In case B, the United States has a comparative advantage in wheat and the United Kingdom in cloth.
In case C, the United States has a comparative advantage in wheat and the United Kingdom in cloth.
In case D, the United States and the United Kingdom have a comparative advantage in neither commodity.
4. a. The United States gains 1C.
b. The United Kingdom gains 4C.
c. $3C < 4W < 8C$.
d. The United States would gain 3C, while the United Kingdom would gain 2C.
10. If $D_{W(US + UK)}$ intersected $S_{W(US + UK)}$ at $P_W/P_C = 2/3$ and 120W in the left panel of Figure 2.3, this would mean that the United States would not be specializing completely in the production of wheat.
The United Kingdom, on the other hand, would be specializing completely

in the production of cloth and exchanging 20C for 30W with the United States. Since the United Kingdom trades at the U.S. pretrade relative commodity price of $P_W/P_C = 2/3$, the United Kingdom receives all of the gains from trade.

Chapter 3

3. a. See Figure 3.1.
- b. Nation 1 has a comparative advantage in X and Nation 2 in Y .

- c. If the relative commodity price line has equal slope in both nations.

4. a. See Figure 3.2.
- b. Nation 1 gains by the amount by which point E is to the right and above point A and Nation 2 by the excess of E' over A' . Nation 1 gains more from trade because the relative price with trade differs more from its pretrade price than for Nation 2.

7. See Figure 3.3.
The small nation will move from A to B in production and will export X in exchange for Y so as to reach point $E > A$.

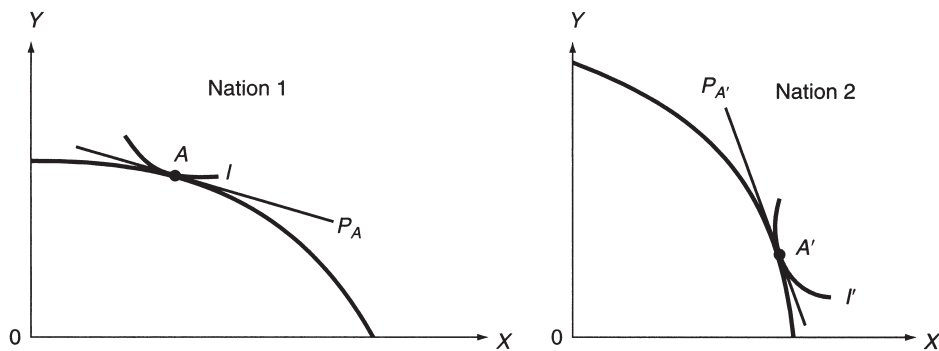


FIGURE 3.1

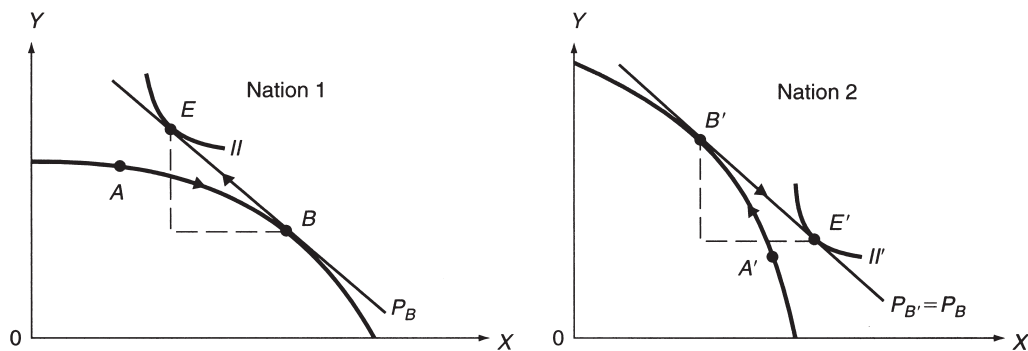


FIGURE 3.2