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CHAPTER 2- FOUNDATIONS OF MODERN TRADE THEORY: COMPARATIVE ADVANTAGE

1. The mercantilists would have objected to:
   a. Export promotion policies initiated by the government
   b. The use of tariffs or quotas to restrict imports
   c. Trade policies designed to accumulate gold and other precious metals
   d. International trade based on open markets

ANSWER: d

2. Unlike the mercantilists, Adam Smith maintained that:
   a. Trade benefits one nation only at the expense of another nation
   b. Government control of trade leads to maximum economic welfare
   c. All nations can gain from free international trade
   d. The world's output of goods must remain constant over time

ANSWER: c

3. The trading principle formulated by Adam Smith maintained that:
   a. International prices are determined from the demand side of the market
   b. Differences in resource endowments determine comparative advantage
   c. Differences in income levels govern world trade patterns
   d. Absolute cost differences determine the immediate basis for trade

ANSWER: d

4. Unlike Adam Smith, David Ricardo's trading principle emphasizes the:
   a. Demand side of the market
   b. Supply side of the market
   c. Role of comparative costs
   d. Role of absolute costs

ANSWER: c

5. When a nation requires fewer resources than another nation to produce a product, the nation is said to have a:
   a. Absolute advantage in the production of the product
   b. Comparative advantage in the production of the product
   c. Lower marginal rate of transformation for the product
   d. Lower opportunity cost of producing the product

ANSWER: a

6. According to the principle of comparative advantage, specialization and trade increase a nation's total output since:
   a. Resources are directed to their highest productivity
   b. The output of the nation's trading partner declines
   c. The nation can produce outside of its production possibilities curve
   d. The problem of unemployment is eliminated

ANSWER: a

7. In a two-product, two-country world, international trade can lead to increases in:

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a. Consumer welfare only if output of both products is increased
b. Output of both products and consumer welfare in both countries
c. Total production of both products, but not consumer welfare in both countries
d. Consumer welfare in both countries, but not total production of both products

ANSWER: b

8. As a result of international trade, specialization in production tends to be:
a. Complete with constant costs--complete with increasing costs
b. Complete with constant costs--incomplete with increasing costs
c. Incomplete with constant costs--complete with increasing costs
d. Incomplete with constant costs--incomplete with increasing costs

ANSWER: b

9. A nation that gains from trade will find its consumption point being located:
a. Inside its production possibilities curve
b. Along its production possibilities curve
c. Outside its production possibilities curve
d. None of the above

ANSWER: c

Table 2.1. Output Possibilities of the U.S. and the U.K.

	Output per Worker per day	
Country	Tons of Steel	Televisions
United States	5	45
United Kingdom	10	20

10. Referring to Table 2.1, the United States has the absolute advantage in the production of:
a. Steel
b. Televisions
c. Both steel and televisions
d. Neither steel nor televisions

ANSWER: c

11. Referring to Table 2.1, the United Kingdom has a comparative advantage in the production of:
a. Steel
b. Televisions
c. Both steel and televisions
d. Neither steel nor televisions

ANSWER: a

12. Refer to Table 2.1. If trade opens up between the United States and the United Kingdom, American firms should specialize in producing:
a. Steel

b. Televisions
c. Both steel and televisions
d. Neither steel nor televisions

ANSWER: b

13. Referring to Table 2.1, the opportunity cost of producing one ton of steel in the United States is:

a. 3 televisions
b. 10 televisions
c. 20 televisions
d. 45 televisions

ANSWER: a

14. Refer to Table 2.1. Mutually advantageous trade will occur between the United States and the United Kingdom so long as one ton of steel trades for:

a. At least 1 television, but no more than 2 televisions
b. At least 2 televisions, but no more than 3 televisions
c. At least 3 televisions, but no more than 4 televisions
d. At least 4 televisions, but no more than 5 televisions

ANSWER: b

15. Referring to Table 2.1, the United Kingdom gains most from trade if:

a. 1 ton of steel trades for 2 televisions
b. 1 ton of steel trades for 3 televisions
c. 2 tons of steel trade for 4 televisions
d. 2 tons of steel trade for 5 televisions

ANSWER: b

16. Concerning international trade restrictions, which of the following is <u>false</u>? Trade restrictions:

a. Limit specialization and the division of labor
b. Reduce the volume of trade and the gains from trade
c. Cause nations to produce inside their production possibilities curves
d. May result in a country producing some of the product of its comparative disadvantage

ANSWER: c

17. If a production possibilities curve is <u>bowed out</u> (i.e., concave) in appearance, production occurs under conditions of:

a. Constant opportunity costs
b. Increasing opportunity costs
c. Decreasing opportunity costs
d. Zero opportunity costs

ANSWER: b

18. Increasing opportunity costs suggest that:

a. Resources are not perfectly shiftable between the production of two goods

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b. Resources are fully shiftable between the production of two goods
c. A country's production possibilities curve appears as a straight line
d. A country's production possibilities curve is bowed inward (i.e., convex) in appearance

ANSWER: a

19. The trading-triangle concept is used to indicate a nation's:
a. Exports, marginal rate of transformation, terms of trade
b. Imports, terms of trade, marginal rate of transformation
c. Marginal rate of transformation, imports, exports
d. Terms of trade, exports, imports

ANSWER: d

20. Assuming increasing cost conditions, trade between two countries would not be likely if they have:
a. Identical demand conditions but different supply conditions
b. Identical supply conditions but different demand conditions
c. Different supply conditions and different demand conditions
d. Identical demand conditions and identical supply conditions

ANSWER: d

Table 2.2. Output possibilities for South Korea and Japan

	Output per worker per day	
Country	Tons of steel	VCRs
South Korea	80	40
Japan	20	20

21. Referring to Table 2.2, the opportunity cost of one VCR in Japan is:
a. 1 ton of steel
b. 2 tons of steel
c. 3 tons of steel
d. 4 tons of steel

ANSWER: a

22. Referring to Table 2.2, the opportunity cost of one VCR in South Korea is:
a. 1/2 ton of steel
b. 1 ton of steel
c. 1 1/2 tons of steel
d. 2 tons of steel

ANSWER: d

23. Refer to Table 2.2. According to the principle of absolute advantage, Japan should:
a. Export steel
b. Export VCRs
c. Export steel and VCRs

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d. None of the above; there is no basis for gainful trade

ANSWER: d

24. Refer to Table 2.2. According to the principle of comparative advantage:

a. South Korea should export steel
b. South Korea should export steel and VCRs
c. Japan should export steel
d. Japan should export steel and VCRs

ANSWER: a

25. Refer to Table 2.2. With international trade, what would be the maximum amount of steel that South Korea would be willing to export to Japan in exchange for each VCR?

a. 1/2 ton of steel
b. 1 ton of steel
c. 1-1/2 tons of steel
d. 2 tons of steel

ANSWER: d

26. Refer to Table 2.2. With international trade, what would be the maximum number of VCRs that Japan would be willing to export to South Korea in exchange for each ton of steel?

a. 1 VCR
b. 2 VCRs
c. 3 VCRs
d. 4 VCRs

ANSWER: a

27. The earliest statement of the principle of comparative advantage is associated with:

a. Adam Smith
b. David Ricardo
c. Eli Heckscher
d. Bertil Ohlin

ANSWER: b

28. If Hong Kong and Taiwan had identical labor costs but were subject to increasing costs of production:

a. Trade would depend on differences in demand conditions
b. Trade would depend on economies of large-scale production
c. Trade would depend on the use of different currencies
d. There would be no basis for gainful trade

ANSWER: a

29. If the international terms of trade settle at a level that is between each country's opportunity cost:

a. There is no basis for gainful trade for either country
b. Both countries gain from trade

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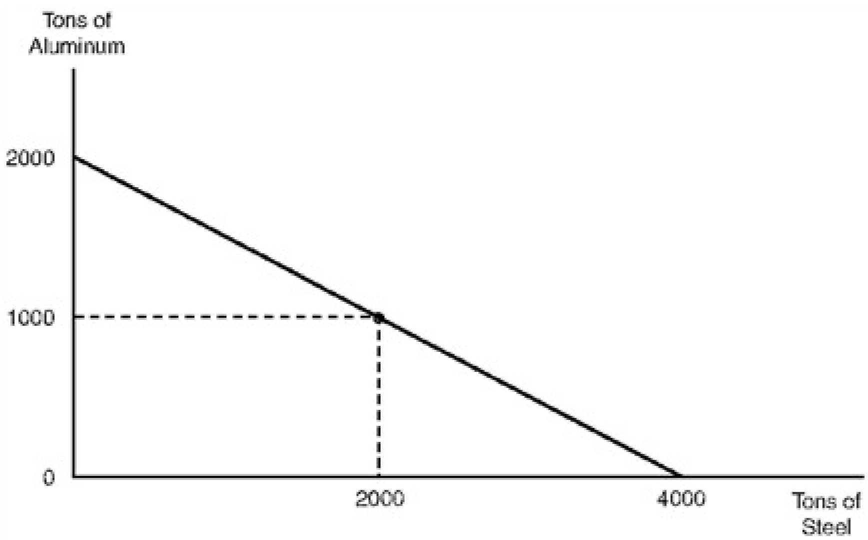
c. Only one country gains from trade
d. One country gains and the other country loses from trade

ANSWER: b

30. International trade is based on the notion that:
a. Different currencies are an obstacle to international trade
b. Goods are more mobile internationally than are resources
c. Resources are more mobile internationally than are goods
d. A country's exports should always exceed its imports

ANSWER: b

Figure 2.1. Production Possibilities Schedule



31. Referring to Figure 2.1, the relative cost of steel in terms of aluminum is:
a. 4.0 tons
b. 2.0 tons
c. 0.5 tons
d. 0.25 tons

ANSWER: c

32. Referring to Figure 2.1, the relative cost of aluminum in terms of steel is:
a. 4.0 tons
b. 2.0 tons
c. 0.5 tons
d. 0.25 tons

ANSWER: b

33. Refer to Figure 2.1. If the relative cost of steel were to rise, then the production possibilities schedule would:
a. Become steeper

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b. Become flatter
c. Shift inward in a parallel manner
d. Shift outward in a parallel manner

ANSWER: a

34. Refer to Figure 2.1. If the relative cost of aluminum were to rise, then the production possibilities schedule would:
a. Become steeper
b. Become flatter
c. Shift inward in a parallel manner
d. Shift outward in a parallel manner

ANSWER: b

35. When a nation achieves autarky equilibrium:
a. Input price equals final product price
b. Labor productivity equals the wage rate
c. Imports equal exports
d. Production equals consumption

ANSWER: d

36. When a nation is in autarky and maximizes its living standard, its consumption and production points are:
a. Along the production possibilities schedule
b. Above the production possibilities schedule
c. Beneath the production possibilities schedule
d. Any of the above

ANSWER: a

37. If Canada experiences <u>increasing</u> opportunity costs, its supply schedule of steel will be:
a. Downward-sloping
b. Upward-sloping
c. Horizontal
d. Vertical

ANSWER: b

38. If Canada experiences <u>constant</u> opportunity costs, its supply schedule of steel will be:
a. Downward-sloping
b. Upward-sloping
c. Horizontal
d. Vertical

ANSWER: c

39. The gains from international trade <u>increase</u> as:
a. A nation consumes inside of its production possibilities schedule
b. A nation consumes along its production possibilities schedule

c. The international terms of trade rises above the nation's autarky price
d. The international terms of trade approaches the nation's autarky price

ANSWER: c

40. In a two-country, two-product world, the statement "Japan enjoys a comparative advantage over France in steel relative to bicycles" is equivalent to:
a. France having a comparative advantage over Japan in bicycles relative to steel
b. France having a comparative disadvantage against Japan in bicycles and steel
c. Japan having a comparative advantage over France in steel and bicycles
d. Japan having a comparative disadvantage against Japan in bicycles and steel

ANSWER: a

41. Ricardo's theory of comparative advantage was of limited real-world validity because it was founded on the:
a. Labor theory of value
b. Capital theory of value
c. Land theory of value
d. Entrepreneur theory of value

ANSWER: a

42. Assume that labor is the only factor of production and that wages in the United States equal $20 per hour while wages in the United Kingdom equal $10 per hour. Production costs would be lower in the United States than the United Kingdom if:
a. U.S. labor productivity equaled 40 units per hour while U.K. labor productivity equaled 15 units per hour
b. U.S. labor productivity equaled 30 units per hour while U.K. labor productivity equaled 20 units per hour
c. U.S. labor productivity equaled 20 units per hour while U.K. labor productivity equaled 30 units per hour
d. U.S. labor productivity equaled 15 units per hour while U.K. labor productivity equaled 25 units per hour

ANSWER: a

43. According to Ricardo, a country will have a comparative advantage in the product in which its:
a. Labor productivity is relatively low
b. Labor productivity is relatively high
c. Labor mobility is relatively low
d. Labor mobility is relatively high

ANSWER: b

44. The Ricardian model of comparative advantage is based on all of the following assumptions except:
a. Only two nations and two products
b. Product quality varies among nations
c. Labor is the only factor of production
d. Labor can move freely within a nation

ANSWER: b

45. The writings of G. MacDougall emphasized which of the following as an explanation of a country's competitive position?

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a. National income levels
b. Relative endowments of natural resources
c. Domestic tastes and preferences
d. Labor compensation and productivity levels

ANSWER: d

46. The introduction of community indifference curves into our trading example focuses attention on the nation's:
a. Income level
b. Resource prices
c. Tastes and preferences
d. Productivity level

ANSWER: c

47. Introducing indifference curves into our trade model permits us to determine:
a. Where a nation chooses to locate along its production possibilities curve in autarky
b. The precise location of a nation's production possibilities curve
c. Whether absolute cost or comparative cost conditions exist
d. The currency price of one product in terms of another product

ANSWER: a

48. In the absence of trade, a nation is in equilibrium where a community indifference curve:
a. Lies above its production possibilities curve
b. Is tangent to its production possibilities curve
c. Intersects its production possibilities curve
d. Lies below its production possibilities curve

ANSWER: b

49. The use of indifference curves helps us determine the point:
a. Along the terms-of-trade line a country will choose
b. Where a country maximizes its resource productivity
c. At which a country ceases to become competitive
d. Where the marginal rate of transformation approaches zero

ANSWER: a

50. With trade, a country will <u>maximize</u> its satisfaction when it:
a. Moves to the highest possible indifference curve
b. Forces the marginal rate of substitution to its lowest possible value
c. Consumes more of both goods than it does in autarky
d. Finds its marginal rate of substitution exceeding its marginal rate of transformation

ANSWER: a

51. Trade between two nations would <u>not</u> be possible if they have:
a. Identical community indifference curves but different production possibilities curves

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b. Identical production possibilities curves but different community indifference curves
c. Different production possibilities curves and different community indifference curves
d. Identical production possibilities curves and identical community indifference curves

ANSWER: d

52. Given a two-country and two-product world, the United States would enjoy all the attainable gains from free trade with Canada if it:

a. Trades at the U.S. rate of transformation
b. Trades at the Canadian rate of transformation
c. Specializes completely in the production of both goods
d. Specializes partially in the production of both goods

ANSWER: b

53. John Stuart Mill's theory of reciprocal demand best applies when trading partners:

a. Are of equal size and importance in the market
b. Produce under increasing cost conditions
c. Partially specialize in the production of commodities
d. Have similar taste and preference levels

ANSWER: a

54. The equilibrium prices and quantities established after trade are fully determinate if we know:

a. The location of all countries' indifference curves
b. The shape of each country's production possibilities curve
c. The comparative costs of each trading partner
d. The strength of world supply and demand for each good

ANSWER: d

55. "The equilibrium relative commodity price at which trade takes place is determined by the conditions of demand and supply for each commodity in both nations. Other things being equal, the nation with the more intense demand for the other nation's exported good will gain less from trade than the nation with the less intense demand." This statement was first proposed by:

a. Alfred Marshall with offer curve analysis
b. John Stuart Mill with the theory of reciprocal demand
c. Adam Smith with the theory of absolute advantage
d. David Ricardo with the theory of comparative advantage

ANSWER: b

56. Which of the following terms-of-trade concepts is calculated by dividing the change in a country's export price index by the change in its import price index between two points in time, multiplied by 100 to express the terms of trade in percentages?

a. Commodity terms of trade
b. Marginal rate of transformation
c. Marginal rate of substitution
d. Autarky price ratio

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ANSWER: a

57. The best explanation of the gains from trade that David Ricardo could provide was to describe only the outer limits within which the equilibrium terms of trade would fall. This is because Ricardo's theory did not recognize how market prices are influenced by:

a. Demand conditions
b. Supply conditions
c. Business expectations
d. Profit patterns

ANSWER: a

58. Under free trade, Sweden enjoys all of the gains from trade with Holland if Sweden:

a. Trades at Holland's rate of transformation
b. Trades at Sweden's rate of transformation
c. Specializes completely in the production of its export good
d. Specializes partially in the production of its export good

ANSWER: a

59. Because the Ricardian trade theory recognized only how supply conditions influence international prices, it could determine:

a. The equilibrium terms of trade
b. The outer limits for the terms of trade
c. Where a country chooses to locate along its production possibilities curve
d. Where a country chooses to locate along its trade triangle

ANSWER: b

60. The terms of trade is given by the prices:

a. Paid for all goods imported by the home country
b. Received for all goods exported by the home country
c. Received for exports and paid for imports
d. Of primary products as opposed to manufactured products

ANSWER: c

Table 2.3. Terms of Trade

	Export Price Index		Import Price Index	
Country	1990	2004	1990	2004
Mexico	100	220	100	200
Sweden	100	160	100	150
Spain	100	155	100	155
France	100	170	100	230
Denmark	100	120	100	125

61. Referring to Table 2.3, which countries' terms of trade improved between 1990 and 2004?

a. Mexico and Denmark

b. Sweden and Denmark
c. Sweden and Spain
d. Mexico and Sweden

ANSWER: d

62. Referring to Table 2.3, which countries' terms of trade worsened between 1990 and 2004?
a. Spain and Mexico
b. Mexico and France
c. France and Denmark
d. Denmark and Sweden

ANSWER: c

63. Referring to Table 2.3, which country's terms of trade did not change between 1990 and 2004?
a. Spain
b. Sweden
c. France
d. Denmark

ANSWER: a

64. Given free trade, small nations tend to benefit the most from trade since they:
a. Are more productive than their large trading partners
b. Are less productive than their large trading partners
c. Have demand preferences and income levels lower than their large trading partners
d. Enjoy terms of trade lying near the opportunity costs of their large trading partners

ANSWER: d

65. A terms-of-trade index that equals 150 indicates that compared to the base year:
a. It requires a greater output of domestic goods to obtain the same amount of foreign goods
b. It requires a lesser amount of domestic goods to obtain the same amount of foreign goods
c. The price of exports has risen from $100 to $150
d. The price of imports has risen from $100 to $150

ANSWER: b

66. A term-of-trade index that equals 90 indicates that compared to the base year:
a. It requires a greater output of domestic goods to obtain the same amount of foreign goods
b. It requires a lesser amount of domestic goods to obtain the same amount of foreign goods
c. The price of exports has fallen from $100 to $90
d. The price of imports has fallen from $100 to $90

ANSWER: a

67. The theory of reciprocal demand does not well apply when one country:
a. Produces under constant cost conditions
b. Produces along its production possibilities curve

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c. Is of minor economic importance in the world marketplace
d. Partially specializes the production of its export good

ANSWER: c

68. The terms of trade is given by:
a. (Price of exports/price of imports) − 100
b. (Price of exports/price of imports) + 100
c. (Price of exports/price of imports) ÷ 100
d. (Price of exports/price of imports) × 100

ANSWER: d

69. If Japan and France have identical production possibilities curves and identical community indifference curves:
a. Japan will enjoy all the gains from trade
b. France will enjoy all the gains from trade
c. Japan and France share equally in the gains from trade
d. Gainful specialization and trade are not possible

ANSWER: d

70. A rise in the price of imports or a fall in the price of exports will:
a. Improve the terms of trade
b. Worsen the terms of trade
c. Expand the production possibilities curve
d. Contract the production possibilities curve

ANSWER: b

71. A fall in the price of imports or a rise in the price of exports will:
a. Improve the terms of trade
b. Worsen the terms of trade
c. Expand the production possibilities curve
d. Contract the production possibilities curve

ANSWER: a

72. Under free trade, Canada would not enjoy any gains from trade with Sweden if Canada:
a. Trades at the Canadian rate of transformation
b. Trades at Sweden's rate of transformation
c. Specializes completely in the production of its export good
d. Specializes partially in the production of its export good

ANSWER: a

Figure 2.2 illustrates trade data for Canada. The figure assumes that Canada attains international trade equilibrium at point C.

Figure 2.2. Canadian Trade Possibilities

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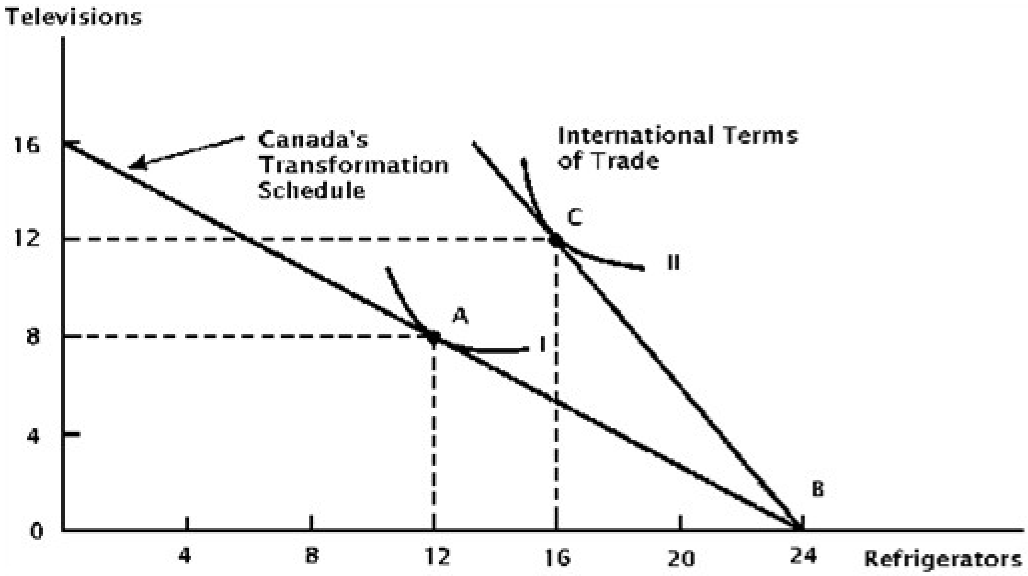

73. Consider Figure 2.2. In the absence of trade, Canada would produce and consume:

a. 8 televisions and 16 refrigerators
b. 12 televisions and 16 refrigerators
c. 8 televisions and 12 refrigerators
d. 12 televisions and 8 refrigerators

ANSWER: c

74. Referring to Figure 2.2, Canada has a comparative advantage in:

a. Televisions
b. Refrigerators
c. Televisions and refrigerators
d. Neither televisions nor refrigerators

ANSWER: b

75. Consider Figure 2.2. With specialization, Canada produces:

a. 16 televisions
b. 12 televisions and 8 refrigerators
c. 8 televisions and 16 refrigerators
d. 24 refrigerators

ANSWER: d

76. Consider Figure 2.2. With trade, Canada consumes:

a. 12 televisions and 8 refrigerators
b. 12 televisions and 16 refrigerators
c. 8 televisions and 16 refrigerators
d. 24 refrigerators

ANSWER: b

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CHAPTER 2- FOUNDATIONS OF MODERN TRADE THEORY: COMPARATIVE ADVANTAGE

77. According to Figure 2.2, exports for Canada total:

a. 16 refrigerators
b. 8 refrigerators
c. 12 refrigerators
d. 16 refrigerators

ANSWER: b

78. According to Figure 2.2, imports for Canada total:

a. 6 televisions
b. 8 televisions
c. 12 televisions
d. 16 televisions

ANSWER: c

79. Concerning possible determinants of international trade, which are sources of comparative advantage? Differences in:

a. Methods of production
b. Tastes and preferences
c. Technological know-how
d. All of the above

ANSWER: d

80. Ricardo's model of comparative advantage assumed all of the following except:

a. In each nation, labor is the only input
b. Costs do not vary with the level of production
c. Perfect competition prevails in all markets
d. Transportation costs rise as distance increases between countries

ANSWER: d

81. Ricardo's model of comparative advantage assumed all of the following except:

a. Trade is balanced, thus ruling out flows of money between nations
b. Firms make production decisions in an attempt to maximize profits
c. Free trade occurs between nations
d. Labor is immobile within a country, but is incapable of moving between countries

ANSWER: d

82. The dynamic gains from trade include all of the following except:

a. Economies of large-scale production resulting in decreasing unit cost
b. Increased saving and investment resulting in economic growth
c. Increased competition resulting in lower prices and wider range of output
d. Increasing comparative advantage leading to specialization

ANSWER: d

83. All of the following may be exit barriers except

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a. Employee health benefit costs
b. Treatment, storage and disposal costs
c. Penalties for terminating contracts with raw material suppliers
d. Increasing opportunity cost of production

ANSWER: d

84. Incomplete specialization may be caused by
a. Increasing opportunity cost
b. Unrestricted trade
c. Constant opportunity cost
d. Decreasing opportunity cost

ANSWER: a

85. Improvements in productivity may lead to decreasing comparative costs if
a. The assumption of fixed technologies under constant costs is relaxed
b. Technologies available to each nation is allowed to differ
c. Resource endowments are allowed to vary
d. All of the above

ANSWER: d

86. Adam Smith
a. Was a leading advocate of free trade
b. Developed the concept of absolute advantage
c. Maintained that labor costs represent the major determinant of production cost
d. All of the above

ANSWER: d

87. Modern trade theory contends that the pattern of world trade is governed by
a. Differences in supply conditions and demand conditions
b. Supply conditions only
c. Demand conditions only
d. None of the above

ANSWER: a

88. When nations are of similar size, and have similar taste patterns, the gains from trade
a. Are shared equally between them
b. Are impossible to determine
c. Are too small, so that trading is not beneficial
d. Are determined by the nation that has comparative advantage in the more essential product

ANSWER: a

89. The commodity terms of trade measures
a. The rate at which exports exchange for imports

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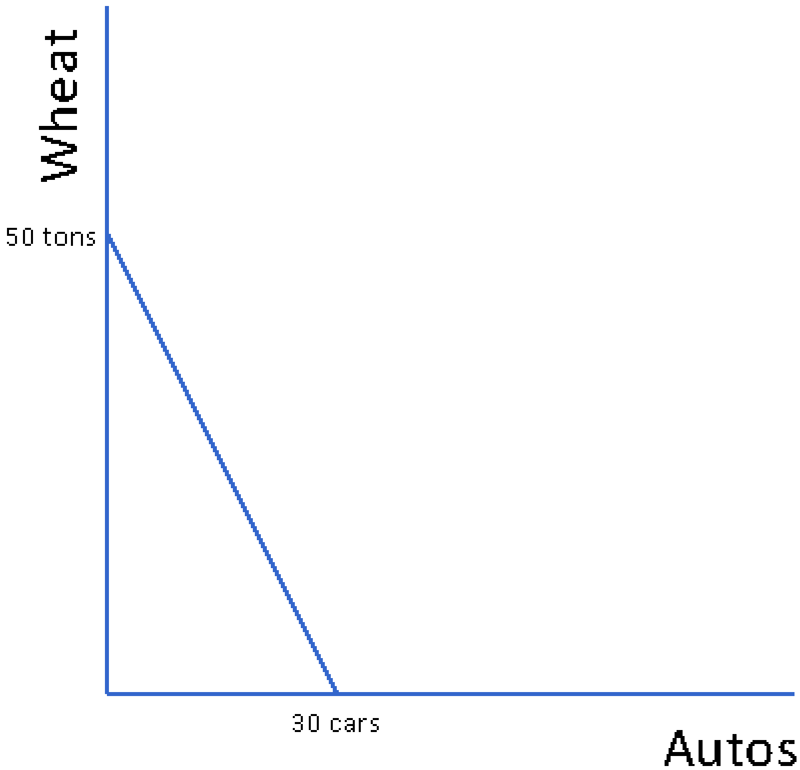
b. The influence trade has on productivity levels
c. The effect on income of the trading nation
d. The improvement in a nation's welfare

ANSWER: a

Figure 2.4 Production Possibilities Frontier



90. In Figure 2.4 the marginal rate of transformation of wheat into autos is
a. one and two-thirds
b. two and one-third
c. three fifths
d. three sevenths

ANSWER: a

91. In Figure 2.4 the marginal rate of transformation of autos into wheat is
a. one and two-thirds
b. two and one-third
c. three fifths
d. three sevenths

ANSWER: c

92. In Figure 2.4 one car can be produced at a cost of

a. one and two-thirds tons of wheat
b. two and one-third tons of wheat
c. three fifths tons of wheat
d. three sevenths tons of wheat

ANSWER: a

93. In Figure 2.4 one ton of wheat can be produced at a cost of
a. one and two-thirds cars
b. two and one-third cars
c. three fifths of a car
d. three sevenths of a car

ANSWER: c

94. According to the mercantilists, a nation's welfare would improve if it maintained a surplus of exports over imports.
a. True
b. False

ANSWER: True

95. The mercantilists maintained that a free-trade policy best enhances a nation's welfare.
a. True
b. False

ANSWER: False

96. The mercantilists contended that because one nation's gains from trade come the expense of its trading partners, not all nations could simultaneously realize gains from trade.
a. True
b. False

ANSWER: True

97. According to the price-specie-flow-doctrine, a trade-surplus nation would experience gold outflows, a decrease in its money supply, and a fall in its price level.
a. True
b. False

ANSWER: False

98. The trade theories of Adam Smith and David Ricardo viewed the determination of competitiveness from the demand side of the market.
a. True
b. False

ANSWER: False

99. According to the principle of absolute advantage, international trade is beneficial to the world if one nation has an absolute cost advantage in the production of one good while the other nation has an absolute cost advantage in the other good.

a. True

b. False

ANSWER: True

100. The principle of absolute advantage asserts that mutually beneficial trade can occur even if one nation is absolutely more efficient in the production of all goods.

a. True

b. False

ANSWER: False

101. The basis for trade is explained by the principle of absolute advantage according to David Ricardo and the principle of comparative advantage according to Adam Smith.

a. True

b. False

ANSWER: False

102. The principle of comparative advantage contends that a nation should specialize in and export the good in which its absolute advantage is smallest or its absolute disadvantage is greatest.

a. True

b. False

ANSWER: False

103. The Ricardian theory of comparative advantage assumes only two nations and two products, labor can move freely within a nation, and perfect competition exists in all markets.

a. True

b. False

ANSWER: True

104. Assume that the United States is more efficient than the United Kingdom in the production of all goods. Mutually beneficial trade is possible according to the principle of absolute advantage, but is impossible according to the principle of comparative advantage.

a. True

b. False

ANSWER: False

105. It is possible for a nation not to have an absolute advantage in anything; but it is not possible for one nation to have a comparative advantage in everything and the other nation to have a comparative advantage in nothing.

a. True

b. False

ANSWER: False

106. Ricardo's theory of comparative advantage was of limited relevance to the real world since it assumed that labor was only one of several factors of production.

a. True

b. False

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ANSWER: False

107. Compared to Ricardian trade theory, modern trade theory provides a more general view of comparative advantage since it is based on all factors of production rather than just labor.

a. True

b. False

ANSWER: True

108. Constant opportunity costs suggest that the relative cost of producing one product in terms of the other will remain the same no matter where a nation chooses to locate on its production-possibilities schedule.

a. True

b. False

ANSWER: True

109. There are two explanations of constant opportunity costs: (1) factors of production are imperfect substitutes for each other; (2) all units of a given factor have different qualities.

a. True

b. False

ANSWER: False

110. With increasing opportunity costs, a nation totally specializes in the production of the commodity of its comparative advantage; with constant opportunity costs, a nation partially specializes in the production of the commodity of its comparative advantage.

a. True

b. False

ANSWER: False

111. A nation's trade triangle denotes its exports, imports, and terms of trade.

a. True

b. False

ANSWER: True

112. International trade leads to increased welfare if a nation can achieve a post-trade consumption point lying inside of its production-possibilities schedule.

a. True

b. False

ANSWER: False

113. If the U.S. post-trade consumption point lies along its production possibilities schedule, the United States achieves a higher level of welfare with trade than without trade.

a. True

b. False

ANSWER: False

114. If productivity in the German computer industry grows faster than it does in the Japanese computer industry, the

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opportunity cost of each computer produced in Japan increases relative to the opportunity cost of a computer produced in Germany.

a. True

b. False

ANSWER: True

115. If Japan loses competitiveness in computers, Japanese computer workers lose jobs to foreign computer workers and the wages of Japanese computer workers tend to fall relative to the wages of foreign computer workers.

a. True

b. False

ANSWER: True

116. With constant opportunity costs, a nation will achieve the greatest possible gains from trade if it partially specializes in the production of the commodity of its comparative disadvantage.

a. True

b. False

ANSWER: False

117. By reducing the overall volume of trade, import restrictions tend to reduce a nation's gains from trade.

a. True

b. False

ANSWER: True

118. According to the principle of comparative advantage, an open trading system results in resources being channeled from uses of low productivity to those of high productivity.

a. True

b. False

ANSWER: True

119. With increasing opportunity costs, comparative advantage depends on a nation's supply conditions and demand conditions; with constant opportunity costs, comparative advantage depends only on demand conditions.

a. True

b. False

ANSWER: False

120. The existence of exit barriers tends to delay the closing of inefficient firms that face international competitive disadvantages.

a. True

b. False

ANSWER: True

121. MacDougall's empirical study of comparative advantage was based on the notion that a product's labor cost is underlaid by labor productivity and the wage rate.

a. True

b. False

ANSWER: True

122. The MacDougall study of comparative advantage hypothesized that in those industries in which U.S. labor productivity was relatively high, U.S. exports to the world should be lower than U.K. exports to the world, after adjusting for wage differentials.

a. True

b. False

ANSWER: False

123. The basic idea of mercantilism was that wealth consisted of the goods and services produced by a nation.

a. True

b. False

ANSWER: False

124. According to Adam Smith, international trade was a "win-win" situation since all nations could enjoy gains from trade.

a. True

b. False

ANSWER: True

125. The price-specie-flow mechanism illustrated why one nation's gains from trade were accompanied by another country's losses.

a. True

b. False

ANSWER: False

126. Complete specialization usually occurs under the assumption of increasing opportunity costs.

a. True

b. False

ANSWER: False

127. Adam Smith contended that gold, silver, and other precious metals constituted the wealth of a nation.

a. True

b. False

ANSWER: False

128. The price-specie-flow mechanism illustrated why nations could not maintain trade surpluses or trade deficits over the long run.

a. True

b. False

ANSWER: True

129. The marginal rate of transformation equals the absolute slope of a country's production possibilities schedule.

a. True

b. False

ANSWER: True

130. Assume that Germany has higher labor productivity and higher wage levels than France. Germany can produce a commodity more cheaply than France if its productivity differential more than offsets its wage differential.

a. True

b. False

ANSWER: True

131. Ricardo's theory of comparative advantage does <u>not</u> take into account demand conditions when determining relative commodity prices.

a. True

b. False

ANSWER: True

132. If Canada has a higher wage level and higher labor productivity than Mexico, Canada will necessarily produce a good at a higher labor cost than Mexico.

a. True

b. False

ANSWER: False

133. If Argentina has a comparative advantage over Brazil in beef relative to coffee, Argentina will specialize in beef production.

a. True

b. False

ANSWER: True

134. Modern trade theory recognizes that the pattern of world trade is governed by both demand conditions and supply conditions.

a. True

b. False

ANSWER: True

135. A nation achieves autarky equilibrium at the point where its community indifference curve is tangent to its production possibilities schedule.

a. True

b. False

ANSWER: True

136. In autarky equilibrium, a nation realizes the lowest possible level of satisfaction given the constraint of its production possibilities schedule.

a. True

b. False

ANSWER: False

137. A nation benefits from international trade if it can achieve a higher indifference curve than it can in autarky.

a. True

b. False

ANSWER: True

138. A nation realizes maximum gains from trade at the point where the international terms-of-trade line is tangent to its community indifference curve.

a. True

b. False

ANSWER: True

139. The Ricardian theory of comparative advantage could fully explain the distribution of the gains from trade among trading partners.

a. True

b. False

ANSWER: False

140. Because the Ricardian theory of comparative advantage was based only on a nation's demand conditions, it could not fully explain the distribution of the gains from trade among trading partners.

a. True

b. False

ANSWER: False

141. Because the Ricardian theory of comparative advantage was based only on a nation's supply conditions, it could only determine the outer limits within which the equilibrium terms of trade would lie.

a. True

b. False

ANSWER: True

142. The domestic cost ratios of nations set the outer limits to the equilibrium terms of trade.

a. True

b. False

ANSWER: True

143. Mutually beneficial trade for two countries occurs if the equilibrium terms of trade lies between the two countries' domestic cost ratios.

a. True

b. False

ANSWER: True

144. Assume that the United States and Canada engage in trade. If the international terms of trade coincides with the U.S. cost ratio, the United States realizes all of the gains from trade with Canada.

a. True

b. False

ANSWER: False

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145. Assume that the United States and Canada engage in trade. If the international terms of trade coincides with the Canadian cost ratio, the United States realizes all of the gains from trade with Canada.

a. True

b. False

ANSWER: True

146. If the international terms of trade lies beneath (inside) the Mexican cost ratio, Mexico is worse off with trade than without trade.

a. True

b. False

ANSWER: True

147. Although J. S. Mill recognized that the region of mutually beneficial trade is bounded by the cost ratios of two countries, it was not until David Ricardo developed the theory of reciprocal demand that the equilibrium terms of trade could be determined.

a. True

b. False

ANSWER: False

148. According to J. S. Mill, if we know the domestic demand expressed by both trading partners for both products, the equilibrium terms of trade can be defined.

a. True

b. False

ANSWER: True

149. The theory of reciprocal demand asserts that as the U.S. demand for Canadian wheat rises, the equilibrium terms of trade improve for the United States.

a. True

b. False

ANSWER: False

150. Assume that Canada has a comparative advantage in wheat and a comparative disadvantage in autos. As the Canadian demand for wheat increases, Canada's equilibrium terms of trade improves.

a. True

b. False

ANSWER: False

151. The theory of reciprocal demand best applies when two countries are of equal economic size, so that the demand conditions of each nation have a noticeable impact on market prices.

a. True

b. False

ANSWER: True

152. The theory of reciprocal demand best applies when one country has a "large" economy and the other country has a "small" economy.

a. True
b. False

ANSWER: False

153. If two nations of approximately the same size and with similar taste patterns participate in international trade, the gains from trade tend to be shared about equally between them.

a. True
b. False

ANSWER: True

154. The expression "importance of being unimportant" suggests that if one nation is much larger than the other, the larger nation realizes most of the gains from trade while the smaller nation realizes fewer gains from trade.

a. True
b. False

ANSWER: False

155. An improvement in a nation's terms of trade occurs if the prices of its exports rise relative to the prices of its imports over a given time period.

a. True
b. False

ANSWER: True

156. If a country's terms of trade worsen, it must exchange fewer exports for a given amount of imports.

a. True
b. False

ANSWER: False

157. If a country's terms of trade improve, it must exchange more exports for a given amount of imports.

a. True
b. False

ANSWER: False

158. The terms of trade represents the rate of exchange between a country's exports and imports.

a. True
b. False

ANSWER: True

159. Assume 1990 to be the base year. If by the end of 2004 a country's export price index rose from 100 to 130 while its import price index rose from 100 to 115, its terms of trade would equal 113.

a. True
b. False

ANSWER: True

160. Assume 1990 to be the base year. If by the end of 2004 a country's export price index rose from 100 to 140 while its import price index rose from 100 to 160, its terms of trade would equal 120.

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a. True

b. False

ANSWER: False

161. Assume 1990 to be the base year. If by the end of 2004 a country's export price index rose from 100 to 125 while its import price index rose from 100 to 125, its terms of trade would equal 100.

a. True

b. False

ANSWER: True

162. The commodity terms of trade are found by dividing a country's import price index by its export price index.

a. True

b. False

ANSWER: False

163. For the commodity terms of trade to improve, a country's export price index must rise relative to its import price index over a given time period.

a. True

b. False

ANSWER: True

164. For the commodity terms of trade to improve, a country's import price index must rise relative to its export price index over a given time period.

a. True

b. False

ANSWER: False

165. Is it possible to add up the preferences of all consumers in an entire nation?

ANSWER: No. It is impossible to make interpersonal comparisons of satisfaction, and thus it is not possible to add up preferences.

166. Who gains more from trade, when nations are of unequal economic size?

ANSWER: If one nation is significantly larger than the other, the larger nation attains fewer gains from trade, while the smaller nation captures most of the gains from trade.

167. Is it possible for comparative advantage to change, thus changing the direction of trade?

ANSWER: Lagging productivity growth may cause a country to lose its comparative advantage. In a two-product, two-country model, this would change the direction of trade.

168. Explain the Law of Comparative Advantage.

ANSWER: The Law of Comparative Advantage asserts that with trade, each country will find it favorable to specialize in the production of the good of its comparative advantage, and will trade part of this for the good of its comparative disadvantage. Taking advantage of specialization can result in production gains.

169. Discuss the pitfalls of outsourcing, especially as experienced by Boeing.

ANSWER: Boeing outsourced its production capabilities for the Boeing 787 Dreamliner to facilities in several different countries, each of which made one component part of the aircraft. The plane would be assembled in the U.S. Boeing also required these manufacturers, as a condition of getting the contract for production, to fund part of the development of the plane. To save money, some manufacturers outsourced a portion of their part of the job, causing quality problems and production delays. B giving up control over its supply chain, Boeing suffered from delays and parts that did not meet the requirements, and could not be assembled. Production of the planes was 4 years behind schedule, and costly.

170. Is it possible to estimate the gains from trade?

ANSWER: When a nation trades, it enjoys a larger income, owing to a wider range of goods available to consumers. Trade also has a positive influence on productivity levels. However, it is extremely difficult to measure these gains, since it requires knowledge of what a nation's imports would cost if it produced them itself, instead of purchasing them from a less expensive source abroad.

171. Modern trade theory concerns the following questions

a. What constitutes the basis for trade?
b. At what terms of trade are products exchange in the world market?
c. What are the gains from trade regarding production and consumption?
d. All of the above

ANSWER: d

172. Which theory attempted to explain why a favorable balance of trade could only exist in the short run, since it would automatically be eliminated in the long run?

a. price-specie flow doctrine
b. theory of absolute advantage
c. theory of comparative advantage
d. theory of fluctuating incomes

ANSWER: a

173. Both Adam Smith and David Ricardo

a. were advocates of free trade and opponents of protectionism
b. were advocates of protectionism and opponents of free trade
c. developed trade theories based on the demand side of an economy
d. maintained that precious metals represented the wealth of a nation

ANSWER: a

174. In Adam Smith's trade theory, ______ is the only factor of production and is of one quality (homogeneous)

a. land
b. labor
c. capital
d. entrepreneurship

ANSWER: b

175. David Ricardo's simplified trade model is based on all of the assumptions <u>except</u>

a. costs do not vary with the level of production

b. the level of technology is fixed for all nations
c. capital is the only factor of production
d. perfect competition prevails in all markets

ANSWER: c

176. David Ricardo's simplified trade model assumes all of the following except
a. trade is balanced, thus ruling out money flows between nations
b. firms make production decisions in an attempt to maximize profit
c. transportation costs are zero
d. tariffs and quotas are used to protect a nation's producers from foreign competition

ANSWER: d

177. Which of the following trade theories asserts that within the outer limits of the terms of trade, the actual terms of trade is determined by the relative strength of each country's demand for the other country's product?
a. theory of reciprocal demand
b. overlapping demand theory
c. theory of income determination
d. theory of negative externalities

ANSWER: a

178. Referring to the textbook's example of Babe Ruth, the famous player for the New York Yankees-- Ruth switched from being a pitcher to being an outfielder and batter because of the
a. principle of absolute advantage
b. principle of comparative advantage
c. desire to be a mercantilist
d. concept to economies of scale

ANSWER: b

179. All of the following are sources of dynamic gains from trade except
a. specialization and the reallocation of existing resources
b. additional saving and investment that occurs over a period of time
c. economies of large-scale production
d. economic stimulus provided by increasing levels of competition

ANSWER: a

180. During the 1980s, U.S. iron ore workers realized dynamic gains from trade due to
a. diseconomies of large-scale production of iron ore
b. foreign competition inspiring greater productivity for iron ore producers
c. higher oil prices resulting in increased cost of producing iron ore
d. less investment occurring in the iron ore business

ANSWER: b

181. The presence of increasing opportunity costs gives rises to production possibilities schedules that are

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a. downward-sloping straight lines
b. upward-sloping straight lines
c. bowed outward from the diagram's origin
d. bowed inward toward the diagram's origin

ANSWER: c

182. The United States benefits from outsourcing in all of the following ways except
a. reduced costs and increased competitiveness for American producers
b. new exports for American producers
c. repatriated earnings into the American economy
d. less tax revenue for the American government

ANSWER: d

183. Differences in relative product prices between two nations can be attributed to differences in
a. tastes and preferences
b. the level of technology
c. endowments of resources
d. all of the above

ANSWER: d

184. Suppose that a country's post-trade consumption point lies inside of its production possibilities curve. This means that the country
a. gains from trade
b. loses from trade
c. is not affected by trade
d. none of the above

ANSWER: b

185. Suppose that a country's post-trade consumption point lies outside of its production possibilities curve. As a result, the country
a. gains from trade
b. loses from trade
c. is not affected by trade
d. none of the above

ANSWER: a

186. If a production possibilities schedule appears as a downward sloping straight line, there occurs
a. increasing opportunity cost
b. decreasing opportunity cost
c. constant opportunity cost
d. negative opportunity cost

ANSWER: c

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187. International trade tend to be complete, rather than partial, when there occurs

a. constant opportunity cost
b. increasing opportunity cost
c. negative opportunity cost
d. positive opportunity cost

ANSWER: a

188. The so-called ______ shows the amount of one product that a nation must sacrifice in order to obtain one more unit of the second product

a. autarkic cost
b. marginal rate of transformation
c. technology cost
d. accounting cost

ANSWER: b

189. Which of the following is <u>not</u> an argument to support international trade

a. trade can be a powerful antimonopoly tool
b. trade is a way to take advantage of economies of large scale production
c. trade is a method of transferring knowledge and information
d. trade is a method of achieving income equality across sectors of an economy

ANSWER: d

190. International economists use production possibilities curve to help explain

a. relative prices of products
b. levels of production
c. levels of consumption
d. all of the above

ANSWER: d

191. The British economist, G. MacDougall compared the labor productivity ratios and export ratios for the United Kingdom and the United States in order to test

a. Adam Smith's principle of absolute advantage
b. David Hume's price specie flow mechanism
c. David Ricardo's principle of comparative advantage
d. William Benoit's theory of mercantilism

ANSWER: c

192. Suppose that international trade results in an outward shift in a country's production possibilities curve. This would be described as

a. dynamic gains from trade
b. static gains from trade
c. protectionist gains from trade
d. allocative gains from trade

ANSWER: a

193. Outsourcing (offshoring)
   a. harms off of the economy's domestic sectors including households and business
   b. applies only to manufacturing industries instead of service industries
   c. is the transfer of work previously done by domestic workers to workers located in foreign countries
   d. refers to the transfer of money capital from domestic banks to foreign banks

ANSWER: c

194. Advocates of outsourcing by American firms maintain that its advantages consist of
   a. enabling American firms to remain profitable by holding down the cost of production
   b. increasing the demand for American workers in complementary jobs
   c. holding down prices for American consumers
   d. all of the above

ANSWER: d

195. For the United States, outsourcing tends to result from
   a. a change in the pattern of comparative advantage
   b. the desire of domestic firms to keep domestic labor unions happy
   c. poor educational systems that result in domestic workers becoming less productive
   d. highly restrictive import tariffs and import quotas

ANSWER: a

196. Southwestern Airlines justifies its outsourcing of some of its telephone reservation work to people in India on the grounds that outsourcing
   a. helps reduce the firm's costs and increase its competitiveness
   b. allows the firm to repatriate its earnings to the parent company in the United States
   c. allows the firm to purchase goods from other American companies as business expands
   d. all of the above

ANSWER: d

197. Although Apple Inc. employees some 40,000 workers in the United States, it licenses most of the production of its Ipads and Ipods to Foxconn Technology Group, a company located in
   a. Mexico
   b. China
   c. Vietnam
   d. Cambodia

ANSWER: b

198. In defending its strategy of production outsourcing, Apple Inc. notes that
   a. U.S. import tariffs and import quotas are too high
   b. the export subsidies of the U.S. government are too low
   c. there are not enough American workers with the skills the company needs

d. wages are too low in the United States to motivate people to work hard

ANSWER: c

199. Today, about ______ percent of a typical Ford vehicle comes from parts, components, and services purchased from external suppliers, many of which are outside of the United States.

a. 5 percent
b. 15 percent
c. 35 percent
d. 70 percent

ANSWER: d

200. According to Adam Smith, mutually beneficial trade requires each nation to be the least-cost producer of at least one good that it can export to its trading partner.

a. True
b. False

ANSWER: True

201. If an economy is characterized by increasing opportunity costs, increasing the production of steel by constant amounts results in a constant rate of decrease in the production of autos.

a. True
b. False

ANSWER: False

202. If Canada produces computers at a lower relative cost than Germany, Canada is said to have a comparative disadvantage in computers.

a. True
b. False

ANSWER: False

203. If Mexico was to realize an increase in its factors of production, its production possibilities curve would shift inward toward the origin of the diagram.

a. True
b. False

ANSWER: False

204. Mercantilism refers to a system of restraints on imports and the promotion of exports, as used by governments in the 1600s and 1700s.

a. True
b. False

ANSWER: True

Answer questions 205 and 206 using the information in the following table

Output per labor hour (tons)

Steel	Aluminum

Germany	30	80
Brazil	20	40

205. Germany has the absolute advantage in producing both steel and aluminum.

a. True

b. False

ANSWER: True

206. Germany has the comparative advantage in producing steel.

a. True

b. False

ANSWER: False

207. According to the trade model of David Ricardo, the direction of trade is determined by absolute advantage.

a. True

b. False

ANSWER: False

208. The gains from trade are closely related to the difference between the autarky price and the international terms of trade (international price).

a. True

b. False

ANSWER: True

209. Adam Smith and David Ricardo reasoned that in a world of two countries, at least one country will be worse off as the result of trade.

a. True

b. False

ANSWER: False

210. As international trade proceeds, a country will produce more of its import- competing product.

a. True

b. False

ANSWER: False

211. A country with high wages can export to a country with low wages, given sufficiently high labor productivity in the exporting country.

a. True

b. False

ANSWER: True

212. In his empirical test of the principle of comparative advantage, G. MacDougall found that relatively high export ratios are associated with relatively high labor productivity.

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a. True
b. False

ANSWER: True

213. Critics maintain that outsourcing by American businesses results in jobs moving to low-wage countries, to the disadvantage of American workers.

a. True
b. False

ANSWER: True

214. In justifying its production outsourcing strategy, Apple Inc. notes that American workers lack the speed and flexibility the firm needs to produce its electrical products such as Ipod and Ipad.

a. True
b. False

ANSWER: True

215. Analysts wide agree that Boeing’s use of production outsourcing for its 787 has been highly successful in generating greater efficiencies in jetliner production.

a. True
b. False

ANSWER: False