CHAPTER 2—FOUNDATIONS OF MODERN TRADE THEORY: COMPARATIVE ADVANTAGE

MULTIPLE CHOICE

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

   ANS: D PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

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

   ANS: C PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

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

   ANS: D PTS: 1 DIF: Moderate
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

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

   ANS: C PTS: 1 DIF: Moderate
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

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

   ANS: A PTS: 1 DIF: Moderate
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory

KEY: BLOOM'S: Comprehension

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

   ANS: A PTS: 1 DIF: Moderate
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Comprehension

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

   ANS: B PTS: 1 DIF: Moderate
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Comprehension

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

   ANS: B PTS: 1 DIF: Challenging
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Comprehension

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

   ANS: C PTS: 1 DIF: Moderate
   NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
   KEY: BLOOM'S: Application

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

ANS: C PTS: 1 DIF: Moderate NAT: BPROG: Analysis
TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

    ANS: B PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

    ANS: B PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

    ANS: B PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

ANS: C PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

17. If a production possibilities curve is bowed out (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

ANS: B PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

18. Increasing opportunity costs suggest that:
    a. Resources are not perfectly shiftable between the production of two goods
    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

ANS: A PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

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

ANS: D PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

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

ANS: D PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
KEY: BLOOM'S: Application

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

ANS: A PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Application

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

ANS: D PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Application

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

ANS: D PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Application

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

ANS: A PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Application

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

ANS: D PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Application

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

ANS: A PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Application

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

ANS: B PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Knowledge

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

ANS: A PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

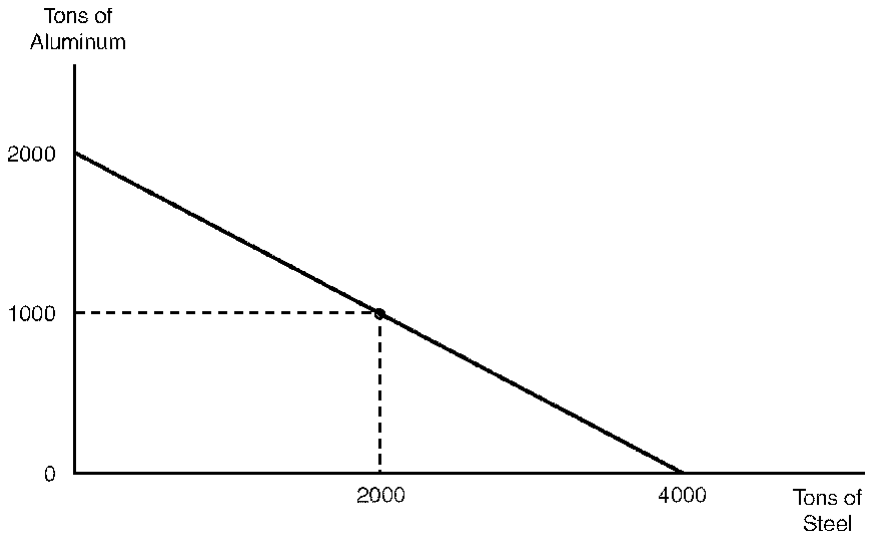
29. If the international terms of trade settle at a level that is between each country's opportunity cost:
    a. There is no basis for gainful trade for either country
    b. Both countries gain from trade
    c. Only one country gains from trade
    d. One country gains and the other country loses from trade

ANS: B PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

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

ANS: B PTS: 1 DIF: Easy NAT: #^
TOP: Production Possibilities Schedules KEY: BLOOM'S: Comprehension

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

    ANS: C PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Application

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

    ANS: B PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Application

33. Refer to Figure 2.1. If the relative cost of steel 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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Application

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

    ANS: B PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Application

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

    ANS: D PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: B PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: C PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: C PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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

ANS: A PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

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

ANS: A PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

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

ANS: A PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Productions Gains From Specialization
KEY: BLOOM'S: Comprehension

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

ANS: B PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

44. The Ricardian model of comparative advantage is based on all of the following assumptions <u>except</u>:
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

ANS: B PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

45. The writings of G. MacDougall emphasized which of the following as an explanation of a country's competitive position?
    a. National income levels
    b. Relative endowments of natural resources
    c. Domestic tastes and preferences
    d. Labor compensation and productivity levels

    ANS: D PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Empirical Evidence on Comparative Advantage
    KEY: BLOOM'S: Knowledge

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

    ANS: C PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: B PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
    KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
    KEY: BLOOM'S: Application

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

ANS: A PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
KEY: BLOOM'S: Application

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

ANS: D PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
KEY: BLOOM'S: Application

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

ANS: B PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: $Equil KEY: BLOOM'S: Application

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

ANS: A PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

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

ANS: D PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: B PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
    KEY: BLOOM'S: Knowledge

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Application

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

    ANS: B PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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

ANS: C PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

    ANS: D PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Equilibrium Terms of Trade KEY: BLOOM'S: Application

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

    ANS: C PTS: 1 DIF: ^ NAT: BPROG: Analysis
    TOP: Equilibrium Terms of Trade KEY: BLOOM'S: Application

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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Equilibrium Terms of Trade KEY: BLOOM'S: Application

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

    ANS: D PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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

ANS: B PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: A PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: C PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: D PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Knowledge

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

ANS: D PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
KEY: BLOOM'S: Comprehension

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

ANS: B PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

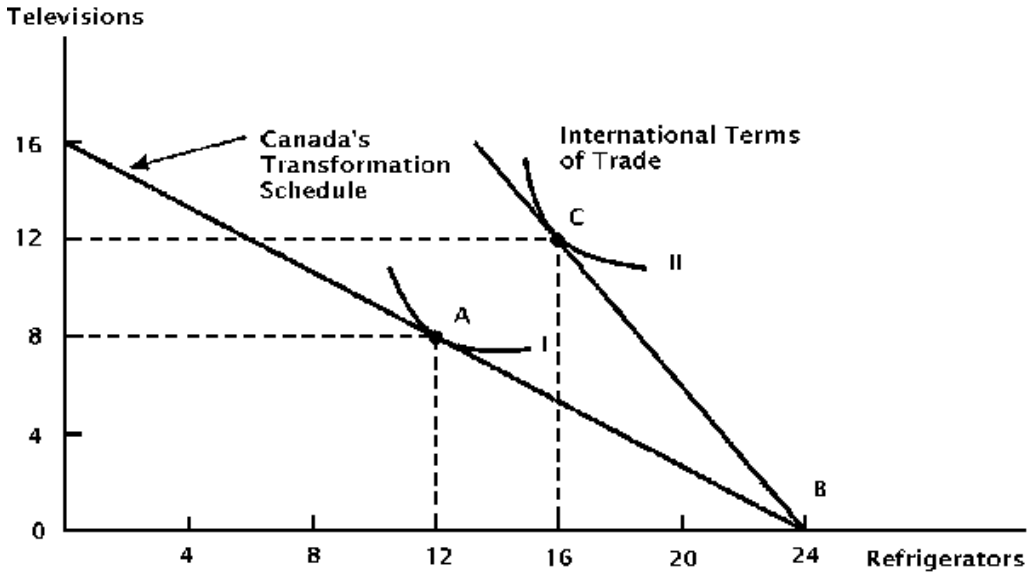
    ANS: A PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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



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

    ANS: C PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

ANS: B PTS: 1 DIF: Challenging NAT: BPROG: Analysis
TOP: Production Possibilities Schedules KEY: #4

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

ANS: D PTS: 1 DIF: Challenging NAT: BPROG: Analysis
TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

ANS: B PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Analysis

77. According to Figure 2.2, exports for Canada total:
a. 16 refrigerators
b. 8 refrigerators
c. 12 refrigerators
d. 16 refrigerators

ANS: B PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Analysis

78. According to Figure 2.2, imports for Canada total:
a. 6 televisions
b. 8 televisions
c. 12 televisions
d. 16 televisions

ANS: C PTS: 1 DIF: Challenging
REF: NAT: BPROG: Reflective Thinking
TOP: Production Possibilities Schedules KEY: BLOOM'S: Analysis

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

ANS: D PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

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

    ANS: D PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
    KEY: BLOOM'S: Comprehension

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

    ANS: D PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Historical Development of Modern Trade Theory KEY: BLOOM'S: Comprehension

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

    ANS: D PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Dynamic Gains from Trade
    KEY: BLOOM'S: Comprehension

83. All of the following may be exit barriers except
    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

    ANS: D PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Exit Barriers KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Trading Under Increasing-Cost Conditions KEY: BLOOM'S: Comprehension

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

    ANS: D PTS: 1 DIF: Moderate NAT: BPROG: Analysis
    TOP: Productions Gains From Specialization KEY: BLOOM'S: Comprehension

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

    ANS: D PTS: 1 DIF: Easy
    NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
    KEY: BLOOM'S: Knowledge

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
    KEY: BLOOM'S: Comprehension

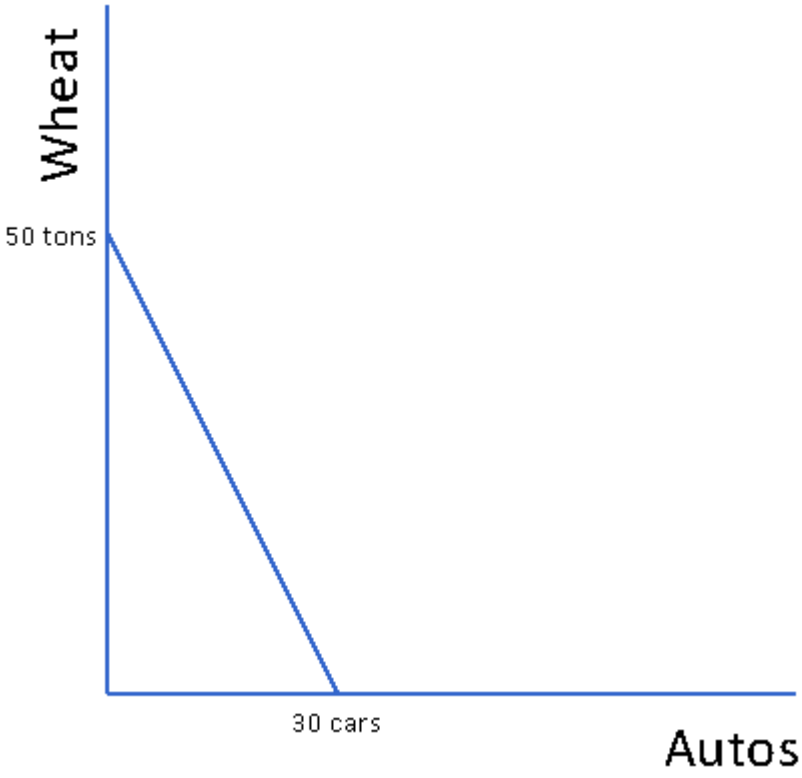
88. When nations are of similar size, and have similar taste patterns, the gains from trade
    a. Are shared equally between them
    b. Are impossible to determine
    c. Are too small, so that trading is not beneficial
    d. Are determined by the nation that has comparative advantage in the more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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Application

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

    ANS: A PTS: 1 DIF: Moderate
    NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
    KEY: BLOOM'S: Comprehension

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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analytic
    TOP: Trading Under Constant-Cost Conditions KEY: BLOOM'S: Analysis

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

    ANS: C PTS: 1 DIF: Moderate NAT: BPROG: Analytic
    TOP: Trading Under Constant-Cost Conditions KEY: BLOOM'S: Analysis

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

    ANS: A PTS: 1 DIF: Moderate NAT: BPROG: Analytic
    TOP: Trading Under Constant-Cost Conditions KEY: BLOOM'S: Analysis

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

ANS: C PTS: 1 DIF: Moderate NAT: BPROG: Analytic
TOP: Trading Under Constant-Cost Conditions KEY: BLOOM'S: Analysis

TRUE/FALSE

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

   ANS: T PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

2. The mercantilists maintained that a free-trade policy best enhances a nation's welfare.

   ANS: F PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

3. 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.

   ANS: T PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

4. 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.

   ANS: F PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

5. The trade theories of Adam Smith and David Ricardo viewed the determination of competitiveness from the demand side of the market.

   ANS: F PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

6. 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.

   ANS: T PTS: 1 DIF: Easy
   NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
   KEY: BLOOM'S: Knowledge

7. 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.

ANS: F PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

8. 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.

ANS: F PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

9. 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.

ANS: F PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

10. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

11. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

12. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

13. 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.

ANS: F PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

14. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

15. 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.

ANS: T PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

16. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

17. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

20. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

21. If productivity in the German computer industry grows faster than it does in the Japanese computer industry, the opportunity cost of each computer produced in Japan increases relative to the opportunity cost of a computer produced in Germany.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

22. 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.

ANS: T PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

23. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

25. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Increasing-Cost Conditions
KEY: BLOOM'S: Comprehension

26. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: *Exit KEY: BLOOM'S: Comprehension

28. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Empirical Evidence on Comparative Advantage
KEY: BLOOM'S: Knowledge

29. 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.

ANS: F PTS: 1 DIF: Easy

NAT: BPROG: Reflective Thinking TOP: Empirical Evidence on Comparative Advantage
KEY: BLOOM'S: Knowledge

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

ANS: F PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

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

ANS: F PTS: 1 DIF: Easy
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Knowledge

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Production Possibilities Schedules
KEY: BLOOM'S: Comprehension

37. 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.

ANS: T PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

38. Ricardo's theory of comparative advantage does not take into account demand conditions when determining relative commodity prices.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

39. 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.

ANS: F PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Trading Under Constant-Cost Conditions
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Easy NAT: #^
TOP: Trading Under Constant-Cost Conditions KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking
TOP: Comparative Advantage Extended to Many Products an KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

47. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

48. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Historical Development of Modern Trade Theory
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

51. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

52. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

54. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

55. 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.

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

56. 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.

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

57. 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.

ANS: F PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Changing Comparative Advantage
KEY: BLOOM'S: Comprehension

58. 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.

ANS: T PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

60. 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.

ANS: T PTS: 1 DIF: Moderate

NAT: BPROG: Reflective Thinking TOP: Distributing the Gains From Trade
KEY: BLOOM'S: Comprehension

61. 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.

ANS: F PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

62. 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.

ANS: T PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: F PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

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

ANS: T PTS: 1 DIF: Moderate
NAT: BPROG: Reflective Thinking TOP: Equilibrium Terms of Trade
KEY: BLOOM'S: Comprehension

66. 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.

ANS: T PTS: 1 DIF: Challenging NAT: BPROG: Analysis
TOP: Terms-of-Trade Estimates KEY: BLOOM'S: Application

67. 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.

ANS: F PTS: 1 DIF: Challenging NAT: BPROG: Analysis
TOP: Terms-of-Trade Estimates KEY: BLOOM'S: Application

68. 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.

ANS: T PTS: 1 DIF: Challenging
NAT: BPROG: Reflective Thinking TOP: Terms-of-Trade Estimates
KEY: BLOOM'S: Application

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

ANS: F PTS: 1 DIF: Moderate NAT: BPROG: Analysis
TOP: Terms-of-Trade Estimates KEY: BLOOM'S: Application

70. 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.

ANS: T PTS: 1 DIF: Moderate NAT: BPROG: Analysis
TOP: Terms-of-Trade Estimates KEY: BLOOM'S: Application

71. 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.

ANS: F PTS: 1 DIF: Moderate NAT: BPROG: Analysis
TOP: Terms-of-Trade Estimates KEY: BLOOM'S: Application

SHORT ANSWER

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

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

PTS: 1 DIF: Challenging NAT: BPROG: Reflective Thinking
TOP: Trading Under Increasing-Cost Conditions KEY: BLOOM'S: Comprehension

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

ANS:
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.

PTS: 1 DIF: Moderate NAT: BPROG: Reflective Thinking
TOP: Equilibrium Terms of Trade KEY: BLOOM'S: Comprehension

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

ANS:
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.

PTS: 1 DIF: Moderate NAT: BPROG: Reflective Thinking
TOP: Changing Comparative Advantage KEY: BLOOM'S: Comprehension

4. Do national security concerns lead to incomplete specialization?

ANS:
Yes. National security concerns may lead a country to produce some of the commodity in which it has comparative disadvantage, thus leading to incomplete specialization.

PTS: 1 DIF: Moderate NAT: BPROG: Reflective Thinking
TOP: Trading Under Increasing-Cost Conditions KEY: BLOOM'S: Comprehension

ESSAY

1. Will it be impossible to keep low-skilled jobs in the U.S.?

   ANS:
   If tax credits or other incentives are made available to U.S. companies, it would be possible for those companies to invest in training or technology for low-skilled workers. That would improve the efficiency of the workers. Such improvements in productivity can more than outweigh the wage advantage that is enjoyed by low-skilled workers overseas. New Balance Athletic Shoe Co. Inc., headquartered in Boston, Massachusetts, has been successful in retaining low-skilled production in the United States by increasing worker productivity.

   PTS: 1 DIF: Moderate NAT: BPROG: Reflective Thinking
   TOP: Comparative Advantage, Free Trade & Outsourcing KEY: BLOOM'S: Comprehension

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

   ANS:
   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.

   PTS: 1 DIF: Moderate NAT: BPROG: Reflective Thinking
   TOP: Empirical Evidence on Comparative Advantage KEY: BLOOM'S: Comprehension