Chapter 2 - Why Nations Trade

VI. Objective Questions

Answer the next 9 questions using figures in the table below.

	Production Costs per unit of Output	
	Corn per bu.	Cloth per yd.
U.S.	$ 2	$ 1
U.K.	£ 4	£ 1

1. The opportunity cost of one yard of cloth in the U.S. is
   (a) 1 bu. corn.
   * (b) 1/2 bu. corn.
   (c) 1/4 bu. corn
   (d) 4 bu. corn.

2. The opportunity cost of one yard of cloth in the U.K. is
   (a) 2 bu. corn.
   (b) 4 bu. corn.
   (c) 1/2 bu. corn.
   * (d) 1/4 bu. corn.

3. The opportunity cost of one bu. of corn in the U.S. is
   (a) 4 yd. cloth.
   * (b) 2 yd. cloth.
   (c) 1/4 yd. cloth.
   (d) 1/2 yd. cloth.

4. The opportunity cost of one bu. of corn in the U.K. is:
   * (a) 4 yd. cloth.
   (b) 2 yd. cloth.
   (c) 1/4 yd. cloth.
   (d) 1/2 yd. cloth.

5. When trade opens the
   * (a) U.S. exports corn and imports cloth.
   (b) U.S. exports cloth and imports corn.
   (c) U.K. exports corn and imports cloth.
   (d) U.K. exports both corn and cloth.

6. The limits to mutually beneficial trade dictate 1 bu. of corn will be worth between:
   (a) 4 and 1 yd. of cloth.
   * (b) 4 and 2 yd. of cloth.
   (c) 1/2 and 1/4 yd. of cloth.
   (d) 2 and 1 yd. of cloth.

7. Which of the following is in the U.S. no trade region?
   (a) 1 bu. corn = 4 yd. cloth.

* (b) 1 bu. corn = 1 yd. cloth.
(c) 1 bu. corn = 3 yd. cloth.
(d) 1 bu. corn = 5 yd. cloth.

8. Which of the following is in the U.K. no trade region?
* (a) 1 bu. corn = 5 yd. cloth.
(b) 1 bu. corn = 2 yd. cloth.
(c) 1 bu. corn = 3 yd. cloth.
(d) 1 bu. corn = 1 yd. cloth.

9. Which of the following exchange rates is sustainable?
* (a) $1 = £ 1.5.
(b) $1 = £ 0.5.
(c) $1 = £ 3.0.
(d) $1 = £ 4.0.

Questions 10-13
It takes country A 2 person-hours to produce a microchip and 4 person-hours to produce a yard of cotton.
It takes country B 1 person-hour to produce a microchip or a yard of cotton. Labor is the only factor of production.

10. Both countries would benefit if
(a) B produced both goods and did not trade with A.
(b) A produced both goods and did not trade with B.
* (c) B exported cotton and A exported microchips.
(d) B exported microchips and A exported cotton.

11. Both countries would be willing to trade when
(a) 1 yard of cotton is exchanged for 3 microchips.
* (b) 2 yards of cotton are exchanged for 3 microchips.
(c) 2 yards of cotton are exchanged for 1 microchip.
(d) none of the above.

12. If productivity in cotton production increases in country A so that it now takes 2 person-hours to produce either a microchip or a yard of cotton, then
(a) both countries would still benefit from trade.
(b) trade would be disadvantageous for country B but not A.
* (c) neither country would benefit from trade.
(d) none of the above.

13. If the production process was altered so that both labor and capital were used, then
(a) B should produce only cotton and A should produce only microchips.
(b) A should produce only cotton and B should produce only microchips.
* (c) specialization may be incomplete.
(d) trade would be disadvantageous for both countries.

Questions 14-15
Per unit costs of computers and wheat are $1 & $4 for the U.S. and Rs.5 & Rs.10 for India.

14. From this information, we can say that
(a) the U.S. and India should not trade.
* (b) the U.S. should specialize in the production of computers and India in the production of wheat.

(c) the U.S. should specialize in the production of wheat and India in the production of computers.
(d) one cannot determine how the countries should specialize unless the exchange rate is known.

15. A sustainable exchange rate between India and the U.S. is
* (a) $1 = Rs. 3.75.
(b) $1 = Rs. 7.
(c) $1 = Rs. 1.
(d) $2 = Rs. 1.

16. When production costs are constant, as in the Classical Ricardian model, the production possibilities curve is
(a) convex to the origin.
(b) convex from above.
* (c) a straight line.
(d) a ray from the origin.

17. The source of comparative advantage in the Ricardian model is
(a) factor endowments.
* (b) labor productivity.
(c) country size.
(d) economies of scale.

18. The Ricardian comparative advantage model results in complete specialization due to the assumption of
(a) labor mobility.
(b) identical tastes.
* (c) homogeneous labor.
(d) constant technology.

19. Gains from trade come from
(a) specialization in production.
(b) exposure to different prices.
(c) providing resources in short supply.
* (d) all of the above.

20. Free trade
(a) raises the average price level of goods.
* (b) lowers the average price level of goods.
(c) lowers real income of all workers.
(d) reduces total employment.

21. An important reason for understanding the principle of comparative advantage is
(a) so governments can tax exports.
(b) to reduce total trade.
* (c) so governments can pursue policies to strengthen comparative advantage.
(d) so comparative disadvantage industries can be protected.

22. Which of the following policies is likely to distort the "ranking" of industries in order of comparative advantage?
(a) fiscal policy.
(b) monetary policy.
* (c) tariffs and quotas.
(d) international investment.

VII. Suggested Further Reading

David Ricardo, *On Principles of Political Economy and Taxation*, Cambridge: Cambridge University Press. 1981.