

## Review Questions

1. For which of the following groups of products does the U.S. rely *exclusively* on imports? (a) Petroleum, coal, natural gas, wood; (b) coffee, tea, cocoa, lin; (c) copper, aluminum, iron, steel; (d) computers, typewriters, airplanes, cars.
2. One similarity between international and interregional trade is that in general both must overcome (a) tariffs, (b) differences in language, (c) distance or space, (d) differences in currencies and monetary systems.
3. In the study of international economics we use the tools of (a) microeconomic theory only, (b) macroeconomic theory only, (c) neither micro nor macro theory, (d) both micro and macro theory, but we also extend, adapt and integrate them.

4. With which of the following topics does international economics deal? (a) The pure theory of trade, (b) the theory of commercial policy, (c) the balance of payments, (d) adjustment to disequilibria in the balance of payments, (e) all of the above.
5. To which of the following would the mercantilists have objected? (a) Free trade, (b) stimulating exports, (c) restricting imports, (d) accumulation of gold by their nation.
6. We can best understand Smith's views on trade if we regard them as a reaction to (a) the law of comparative advantage, (b) the mercantilist view on trade, (c) Ricardo's views on trade, (d) all of the above.
7. What proportion of world trade is based on absolute advantage? (a) All, (b) most, (c) some, (d) none.
8. The commodity in which a nation has the least absolute disadvantage represents its area of (a) comparative disadvantage, (b) comparative advantage, (c) absolute advantage, (d) cannot say without additional information.

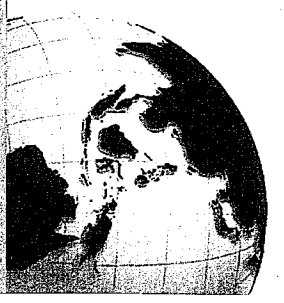
9. With reference to Table 1.2 in Example 4, we can say that the U.S. has a comparative advantage over the U.K. in the production of wheat because one labor-hour in the U.S. is (a) twice as productive in C than in W, (b) twice as productive in W than in C, (c) 1.5 times more productive in W but 6 times more productive in C than in the U.K., (d) 6 times more productive in W but only 1.5 times more productive in C than in the U.K.
10. With reference to Table 1.2 and Examples 4 and 5, indicate which of the following statements is correct. (a) The rate at which W exchanges for C in production in the U.S. is 2:1. (b) The rate at which W exchanges for C in production in the U.K. is 1:2. (c) The rate at which W exchanges for C in trade between the U.S. and the U.K. is 1:1. (d) All of the above.
11. With reference to Example 5, indicate which of the following statements is correct. (a) The U.S. gains 3C by trading 6W for 6C with the U.K. (b) The U.K. gains 6C by exchanging 6W of its 12C for 6W with the U.S. (c) The increase in the combined output of the U.S. and the U.K. when 6W are exchanged for 6C is 9C and 0W. (d) All of the above.
12. Ricardo's law of comparative advantage is based on (a) the opportunity cost theory, (b) the labor theory of value, (c) the law of diminishing returns, (d) all of the above.

# Problems



## INTERNATIONAL ECONOMICS AS A SUBJECT

- 1.1 (a) What does international economics deal with? (b) Why do we study it? (c) How can we justify . . . . .
- 1.2 (a) How do international economic relations differ from interregional economic relations? (b) In what way are they similar? How do both differ from the rest of economics?
- 1.3 (a) How can we measure the degree of economic interdependence of a nation with the rest of the world? (b) Why does the U.S. rely much less on international trade than any other noncommunist developed nation? (c) What would happen to its standard of living if the U.S. withdrew completely from international trade?



**1.4** (a) What is the purpose of theory? (b) What are some of the simplifying assumptions made by international economic theorists? (c) What do they seek to accomplish?

**1.5** (a) Why are the pure theory of international trade and the theory of commercial policy referred to as the microeconomic aspects of international economics? (b) Why are the study of the balance of payments and of the process of adjustment to disequilibria in the balance of payments referred to as the macroeconomic aspects of international economics?

## Problems

- 1.6 (a) How does the mercantilist concept of national wealth differ from today's view? (b) Why did mercantilism advocate the accumulation of gold? (c) How do the mercantilists' views on trade differ from those of Adam Smith?
- 1.7 (a) With reference to Table 1.3, indicate in what commodity the U.S. and the U.K. have an absolute advantage. (b) How much would the U.S. and the U.K. gain if 6W were exchanged for 3C? (c) What if 6W were exchanged for 6C?

Table 1.3

	U.S.	U.K.
Wheat (bushels/labor-hour)	6	1
Cloth (yards/labor-hour)	1	3

- 1.8 (a) How did Adam Smith explain his contention that *all* nations engaged in trade can benefit from trade? (b) Why do nations usually impose restrictions on the free flow of trade?

## COMPARATIVE ADVANTAGE

- 1.9 From Table 1.4, indicate (a) whether the U.S. has an absolute advantage or disadvantage in wheat and cloth, (b) the commodity in which the U.S. and the U.K. have a comparative advantage, and (c) the gains to the U.S. and the U.K. if they exchange 6W for 6C.

Table 1.4

	U.S.	U.K.
Wheat (bushels/labor-hour)	6	1
Cloth (yards/labor-hour)	4	3

- 1.10 (a) If a lawyer earns \$100 per hour at practicing law but can also type faster than her secretary who receives \$10 per hour, does it pay for the lawyer to fire her secretary and do her own typing?  
 (b) The reasoning you employed in answering part (a) is an example of what principle?

1.11 With respect to each part of Table 1.5, indicate in which commodity the U.S. has an absolute and comparative advantage with respect to the U.K. and which commodity the U.S. should export to England.

Table 1.5

	(a)		(b)		(c)	
	U.S.	U.K.	U.S.	U.K.	U.S.	U.K.
Wheat (bushels/labor-hour)	4	2	4	1	4	2
Cloth (yards/labor-hour)	3	2	1	1	2	1

1.12 With reference to Table 1.6 (the same as Table 1.2 in Example 4), indicate what happens if (a) 6W are exchange for 9C, (b) 6W are exchanged for 3C or (c) 6W are exchanged for 12C.

Table 1.6

	A		B	
	U.S.	U.K.	U.S.	U.K.
Wheat (bushels/labor-hour)	6	1	6	1
Cloth (yards/labor-hour)	3	2	3	2



1.13 With reference to Table 1.6, (a) would the U.S. be willing to exchange  $6W$  for less than  $3C$  with the U.K.? Why? (b) Would the U.K. be willing to exchange more than  $12C$  for  $6W$ ? Why? (c) What quantities of  $C$  for  $6W$  represent the limits within which mutually advantageous trade between the U.S. and the U.K. can take place?

1.14 If labor is the only factor of production and is homogeneous (i.e., all of one type), as Smith and Ricardo assumed, (a) express the cost in terms of labor content of producing wheat and cloth in the U.S. and in the U.K. implied by Table 1.6, (b) express the cost or price of wheat ( $P_W^X$ ) in terms of labor content relative to the cost or price of cloth ( $P_C^X$ ) for the U.S. and for the U.K. in the absence of trade and (c) express  $P_C$  relative to  $P_W$  for both the U.S. and the U.K. in the absence of trade.

1.15 With respect to Problem 1.14, (a) express the limits for mutually advantageous trade in terms of  $P_W/P_C$  and  $P_C/P_W$ . (b) If  $P_C/P_W$  is stabilized at 1 with trade, how can you show the gains from trade for the U.S. and the U.K.?

1.16 Given Table 1.8 (the same as Table 1.5), (a) express the cost of producing wheat and cloth in the U.S. and in the U.K. in terms of labor content. (b) Find  $P_C/P_W$  for both the U.S. and the U.K. in the absence of trade. (c) Express the limits for mutually advantageous trade in terms of  $P_C/P_W$ . What does this result indicate?

Table 1.8

	U.S.	U.K.
Wheat (bushels/labor-hour)	4	2
Cloth (yards/labor-hour)	2	1

**1.17** With reference to Table 1.6 and assuming that the wage rate per labor-hour is \$6 in the U.S. and £1.8 in the U.K. (the symbol £ stands for *pound*, the currency of England), (a) express  $P_w$  and  $P_c$  in the U.S. in terms of dollars and in the U.K. in terms of pounds, in the absence of trade. (b) Which commodity will the U.S. import and export if the exchange rate between the dollar and the pound is \$3 per pound (i.e., £1 = \$3)? (c) What if £1 = \$0.50? (d) What if £1 = \$2? If £1 = \$1? (e) When will trade be balanced between the U.S. and the U.K.?

**1.18** State the explicit and implicit assumptions on which Ricardo based his law of comparative advantage.

- (1) Two nations and two commodities
- (2) Free trade
- (3) Perfectly mobile labor within a nation but completely immobile labor internationally
- (4) Constant costs of production
- (5) No transportation costs
- (6) No technological change
- (7) The labor theory of value

**1.19** If in the absence of trade,  $P_w/P_c = 1/2$  in the U.S. and 2 in the U.K., the U.S. has a comparative advantage in and should export wheat to the U.K., while the U.K. has a comparative advantage in and should export cloth to the U.S. If we now add a third nation, Germany, where in the absence of trade  $P_w/P_c = 1$ , explain how multilateral trade among these three nations can take place.

**1.20** With reference to Table 1.10, determine which commodities will be exported and imported by the U.S. if (a) £1 = \$1, (b) £1 = \$2, and (c) £1 = \$0.50.

**Table 1.10**

Commodity	Price in the U.S. \$	Price in the U.K. £
A	1	9
B	4	7
C	6	6
D	8	4
E	12	1