Test 1

Multiple Choice
Identify the choice that best completes the statement or answers the question.

____ 1. Neuewelt is a small country. Currently Neuewelt produces good X. Some of the production is consumed domestically and some of it is exported at the world price ($9). Even though Neuewelt doesn't import good X, they still impose an import tariff of $4 per unit imported. If the Neuewelt government offered an **export subsidy** equal to $4 per unit exported.
a. The will be no change in the consumer surplus in Neuewelt
b. Domestic consumption of good X will increase
c. The consumption effect of the subsidy will be zero
d. Consumer surplus in Neuewelt will decrease

____ 2. Wheat production is land intensive. Given the assumptions of the Heckscher-Ohlin model, the opening of trade in a land-abundant country will cause
a. the domestic price of land to remain unchanged
b. the domestic price of wheat to increase
c. the domestic price of wheat to decrease
d. the domestic price of land to decrease

____ 3. A nation can gain from imposing a tariff if
a. The tariff causes the consumer surplus to increase
b. The tariff is a prohibitive tariff.
c. The tariff causes the world price to decrease
d. The tariff is an ad valorem tariff.

____ 4. Country A has an abundant endowment of land. Land is scarce in the ROW. Wheat production is land intensive. Given the assumptions of the Heckscher-Ohlin model, the opening of trade between the ROW and Country A will cause
a. land prices in Country A to fall
b. wheat prices in Country A to fall
c. the consumer surplus of wheat consumers in Country A to rise
d. the incomes of landowners in Country A to rise

____ 5. When a **large** country imposes an import tariff on good X
a. Consumer surplus in the large country increases.
b. Domestic production of good X decreases
c. World prices of good X increase
d. World prices of good X decrease

____ 6. When Leontief tested the predictions of the Heckscher-Ohlin theory, he found that in 1947 the United States was exporting relatively labor-intensive goods and importing relatively capital-intensive goods. This was called the Leontief Paradox. This finding:
a. Justified the imposition of import tariffs on capital-intensive goods
b. Contradicted the Heckscher-Ohlin theory as the United States was relatively labor-abundant.
c. Fit the predictions of the Heckscher-Ohlin theory concerning the trading patterns of a capital-abundant country.
d. Contradicted the Heckscher-Ohlin theory as the United States was relatively capital-abundant.

____ 7. When countries trade according to each country's respective comparative advantage
   a. Each country will capture some of the gains from trade.
   b. If one country gains from the trade, the other country must lose an equal amount.
   c. The country that imports the most gains. The country that exports the most loses.
   d. The country that exports the most gains. The country that imports the most loses.

____ 8. When a large country imposes an import tariff
   a. Domestic production falls
   b. World prices fall.
   c. Domestic prices fall.
   d. World prices rise.

____ 9. The table below shows the productivity of 1 unit of labor in the production of corn and autos for Country A and the ROW. Assume that production is characterized by constant costs. In this example

Productivity of 1 unit of Labor

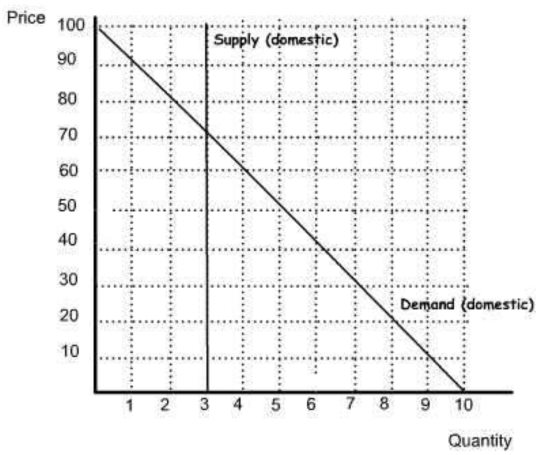
	Country A	ROW
Corn	60	15
Autos	20	15

   a. The ROW has an absolute advantage in corn and autos
   b. The ROW has an absolute advantage in corn and Country A has an absolute advantage in autos
   c. Country A has an absolute advantage in corn and the ROW has an absolute advantage in autos
   d. Country A has an absolute advantage in corn and autos

____ 10. The domestic supply and demand curves for good X in Zimbostan are shown in the figure below. Zimbostan is a large country in the world market for good X. Initially the world price of good X was $30 and at this price Zimbostan produced 3 units domestically, imported 4 units, and domestic consumption was 7 units.

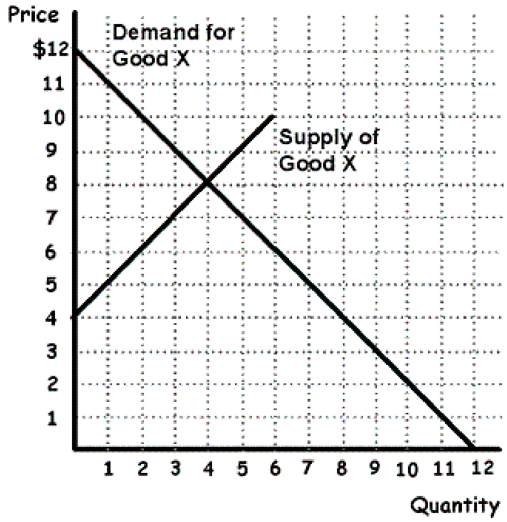
Zimbostan imposed a $30 tariff and the world price fell from $30 to $20. This means the $30 tariff raises the price of good X in Zimbostan from $30 to $50. That is, a $30 tariff causes the domestic price to increase by only $20. Part of the burden of the tariff is born by foreign producers of good X.

As a result of the tariff, in Zimbostan



a. the terms of trade effect of this tariff is $60
b. the protection effect of the tariff is $0
c. the government tariff revenue is $40
d. the consumption effect of this tariff is $0

____ 11. Consider the domestic demand and supply shown below for **small** country A. The **world price is $6**. If there is an **import quota = 2 units**, the price in country A will be



a. $6
b. $8
c. $5
d. $7

____ 12. In the 1800s, California was a land abundant region and New York was a labor abundant region. Wages for labor were higher in California than in New York. When the railroad first connected California to New York, trade between New York and California was opened. As a result, wages in California fell and wages in New York rose. This experience is consistent with

a. The Stolper Samuelson factor price equalization theorem
b. The theory of intraindustry trade
c. The theory of Mercantilism
d. The theory of monopolistic competition

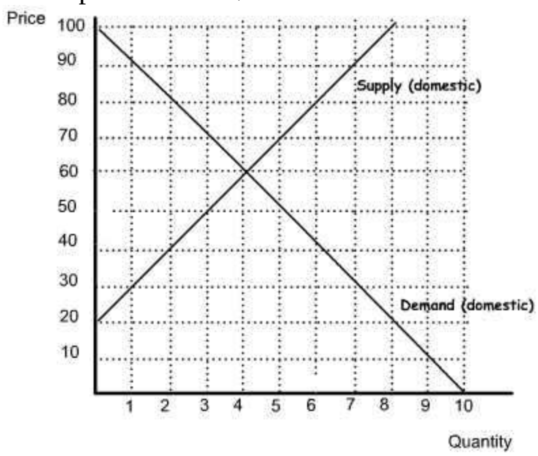
____ 13. In the intra industry trade model trade occurs

a. To take advantage of differences in wage rates
b. For commodities that are homogeneous (little product differentiation)
c. In markets for goods that are labor intensive in production
d. In markets with scale economies and between countries with similar levels of income

____ 14. Suppose Country A is a capital abundant country and the ROW is labor abundant. Shoe production is labor intensive and auto production is capital intensive. In this example above, if there were <u>no trade</u> between Country A and ROW

a. Shoes would be relatively expensive in Country A
b. Labor would be relatively expensive in the ROW
c. Capital would be relatively expensive in Country A
d. Shoes would be relatively expensive in the ROW

____ 15. The graph below shows the domestic supply and demand for product X in a Zimbia, a small country. The world price of X is $70.   If there was free trade

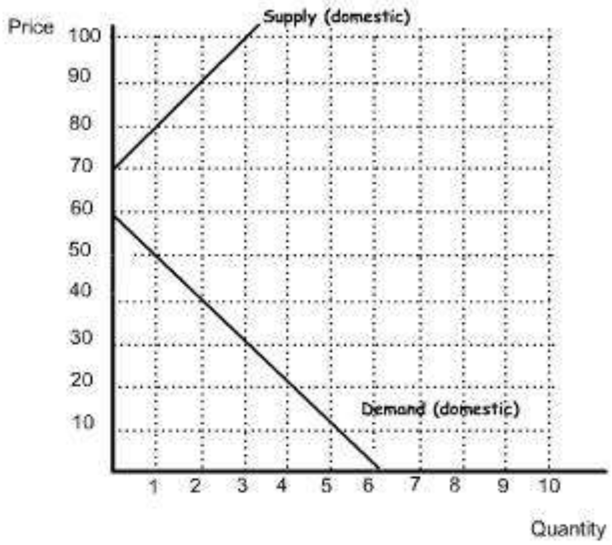


a. Zimbia would   export 2 units
b. Consumer surplus in Zimbia would be about $80
c. Domestic consumption of product X in Zimbia would be 4 units
d. Domestic production of product   X in Zimbia   would be 4   units

____ 16. One insight from Mill's theory of reciprocal demand is that
a. The terms of trade will tend to favor the trading partner that has a relatively smaller market
b. One result of trade is that consumption levels will converge for trading countries
c. Countries that trade tend to have dissimilar consumer tastes and preferences
d. Trade tends to lower the price of commodities and raise the price of services

____ 17. The domestic supply and demand curves of country A for good Q are shown in the figure below. Before opening to international trade, no one produced or consumed good Q in country A because no domestic supplier was willing to sell Q for a price that any domestic consumer was willing to pay. (Note the domestic supply will be zero unless the price is greater than $70 and no domestic consumer is willing to buy Q unless the price is less than $60.). Originally country A prohibited the import of good Q.

The world price of good Q is $20. Country A is a small country and could begin importing good Q without affecting the world price. If trade opened and country A could now freely import good Q



a. Consumer surplus in country A would increase by $80.
b. Producer surplus in country A would decrease by $80.
c. The gains from trade would be $6
d. The redistributive effect would be $80

____ 18. Company X produces radios in Zimbonia. Company X imports $6 of radio components, assembles these components and sells them competively in the domestic Zimbonian radio market.
Company Y produces the same type of radio in another country at a cost of $10 per radio.
Initiially there are no tariffs (no tariffs on imported components and no tariffs on imported radios). Company X and Company Y compete in the Zimbonian radio market and each company sells their radios at a price of $10.
Then Zimbonia imposes a 10% tariff on imported radios. This pushes the domestic price of radios up to $11. In this example,

a. the nominal tariff rate is 0%
b. the nominal tariff rate is 20%
c. the effective tariff rate is 0%
d. the effective tariff rate is 25%

____ 19. The table below presents data on the increased trade flows that followed the formation of NAFTA. The data show that most of the(NAFTA induced) increase in US imports from Canada represented

TABLE 8.5

TRADE EFFECTS OF NAFTA: TRADE CREATION AND TRADE DIVERSION (THOUSANDS OF DOLLARS)

Trade Flow	Trade Expansion	Trade Creation	Trade Diversion
U.S. imports from Canada	$1,074,186	$689,997	$384,189
U.S. imports from Mexico	334,912	284,774	50,138
Canadian imports from the United States	63,656	38,444	25,212
Canadian imports from Mexico	167,264	3,321	163,943
Mexican imports from the United States	77,687	50,036	27,651
Mexican imports from Canada	28,001	902	27,099

Sources: From David Karemera and Kalu Ohah, "An Industrial Analysis of Trade Creation and Trade Diversion of NAFTA," *Journal of Economic Integration*, September 1998, pp. 419–420. See also Gary Clyde Hufbauer and Jeffrey Schott, *NAFTA Revisited: Achievements and Challenges*, Institute for International Economics, Washington, DC, 2005.

a. Increased trade that did not displace trade that previously came from non NAFTA countries
b. US imports that came from Canada rather than Mexico
c. Increased imports from Canada that Canada had imported from Asia and reexported to the US
d. US imports that came from Canada rather than other non Nafta countries

____ 20. Xistan is a small nation. It produces 2 units of product X domestically, imports 12 units of product X, and the world price of product X is $400. The small nation assumption means that the world price of product X will not respond to anything that happens in Xistan (because it is small). When the Xistanian government gave a $25 subsidy to domestic producers of product X for every unit produced domestically we observed that domestic production increased from 2 units (before subsidy) to 7 units (after subsidy). As a result of this subsidy
a. domestic consumer surplus will decrease
b. The increase in producer surplus will be equal to the total subsidy paid
c. The total subsidy paid to domestic producers will equal $25 times 2 units = $50
d. There will be a protective effect which is a loss in surplus due to inefficient production

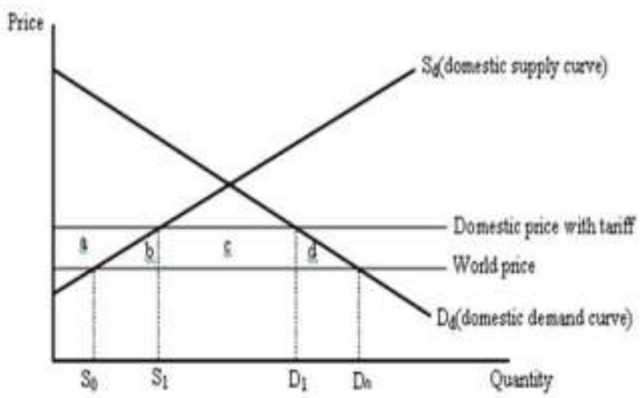
____ 21. Most of international trade is between rich countries with similar factor endowments. For example the majority of US trade is with Canada, Japan, and the European Union and these countries all have wages that are about the same as in the US. Linder would explain this trading pattern to be the result of
a. the high level of tariffs imposed by low income countries
b. the fact that most markets in low income countries are dominated by local monopolists
c. the low productivity of labor in low wage countries
d. the fact that rich countries have similar demands and the producers in rich countries tend to produce goods that are demanded by consumers with high incomes.

____ 22. Suppose a regional trade agreement (a customs union) between country A and country B results in A importing a product from B that it (country A) formerly imported from country C. Country C is not a part of the regional trade agreement. This outcome is called:
a. The trade diversion effect
b. The terms of trade effect
c. The protection effect
d. The triangle effect

____ 23. Customs union theory reasons that the formation of a customs union will <u>decrease</u> members' real welfare when the:

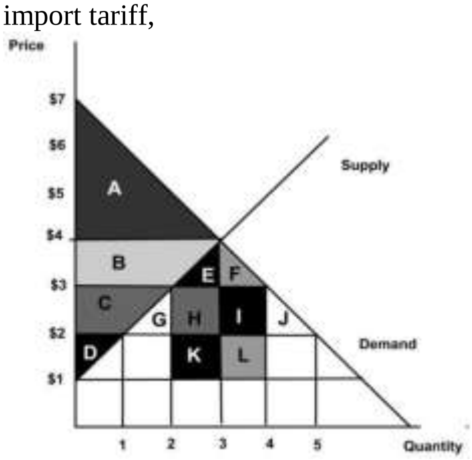
a. Trade consumption effect exceeds the trade production effect
b. Trade production effect exceeds the trade consumption effect
c. Trade creation effect exceeds the trade diversion effect
d. Trade diversion effect exceeds the trade creation effect

____ 24. The figure below shows the domestic market for shoes in a small country. A tariff on shoes caused a deadweight loss (inefficiency) equal to the size of the area _______



a. (a+b+c)
b. (a+b)
c. (b+d)
d. (a+b+c+d)

____ 25. Refer to the figure below. showing the domestic supply and demand for good A in LARGE country Z. The world price is $2. If country Z imposes a $2 per unit import tariff on good A, it will reduce its imports and the world price will decrease to $1. The post tariff price in country Z would then be $3. As a result of this import tariff,

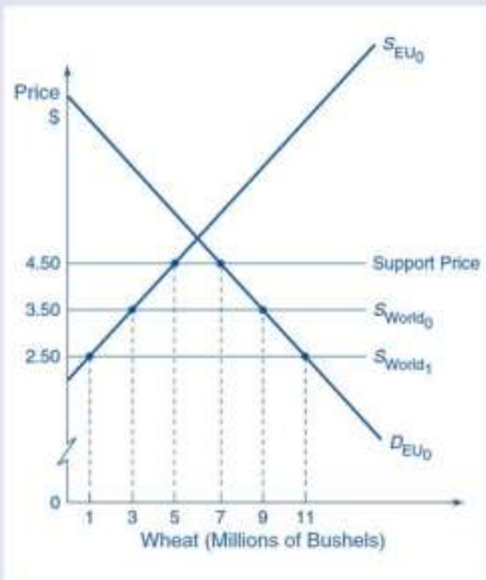


a. domestic consumer surplus will decrease by the size of area {C}
b. domestic producer surplus will not change
c. net national welfare will decrease by the size of area {K+L}
d. government tariff revenues will equal the size of the area {H+I+K+L)

____ 26. The EU's common agricultural policy imposes a variable levy that works like a flexible import tariff. Suppose the EU set a support price of \$4.50 per bushel of wheat. If the world price of wheat was \$3.50 per bushel, the variable levy would equal \$1 (\$4.50-\$3.50).If the world price of wheat was \$2.50 per bushel, the variable levy would equal \$2 (\$4.50-\$2.50). This example is illustrated in the Figure below. In this example if the world price falls from \$3.50 to \$2.50

FIGURE 8.2

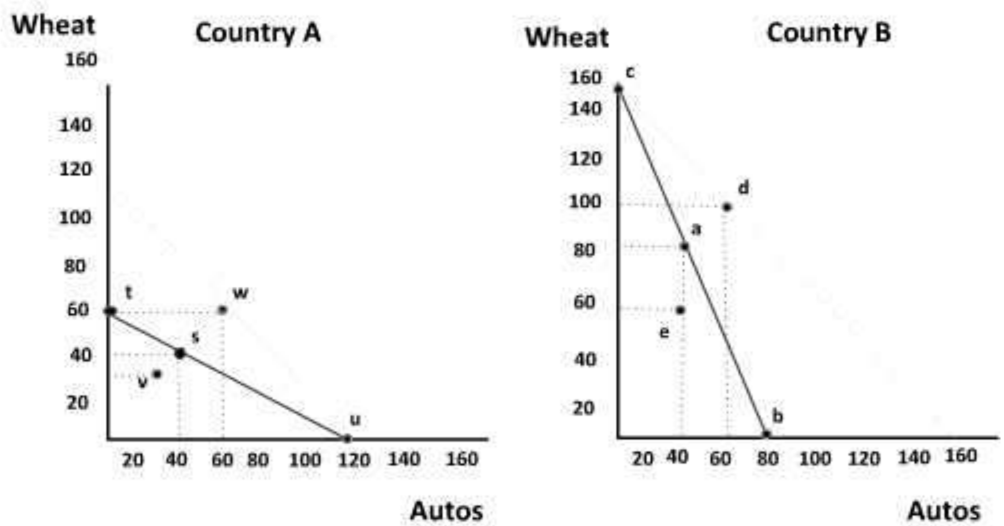
VARIABLE LEVIES



The common agricultural policy of the EU has used variable levies to protect EU farmers from low-cost foreign competition. During periods of falling world prices, the sliding-scale nature of the variable levy results in automatic increases in the EU's import tariff.

a. EU consumers would increase their quantity demanded from 9 units to 11 units
b. EU imports would remain the same
c. EU imports would increase from 2 units to 6 units
d. EU suppliers would reduce their quantity supplied from 3 units to 1 unit

____ 27. In the case of a small country, a quota and a tariff are (almost) identical if:
a. The government allocates licenses to importers through application and selection procedures that require the use of substantial resources.
b. The government allocates licenses for free to importers using a rule or process that involves (almost) no resource cost.
c. The government allocated import licenses directly to the foreign producers using a free lottery system.
d. The government auctions off (sells) licenses to the highest bidder.



____ 28.

The graphs above show the production possibilitiescurves for two countries (Country A and Country B) both producing two products (wheat and autos) with constant costs. Originally there is no trade and country A produces and consumes at point **s** on their PP curve. Country B produces and consumes at point **a** on their PP curve. Each country then specializes according to their respective comparative advantages. Countries A and B could both gain from trade and be willing to trade if the price of 1 unit of autos is

a. greater than .5 units of wheat but less than 2 units of wheat
b. greater than 2 units of wheat but less than 4 units of wheat
c. greater than 4 units of wheat
d. greater than 0 units of wheat but less than .5 units of wheat

____ 29. Most trade is between rich countries trading similar products. It is common for a rich country like France to both export and import different varieties of the same general product. France imports steel from Germany and at the same time France will export other kinds of steel to Germany. This type of trade

a. Can be explained by differences in factor endowments
b. Is called intraindustry trade
c. Generates no gains from trade
d. Is consistent with the predictions of the Heckscher Ohlin theory

____ 30. "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. David Ricardo with the theory of comparative advantage
b. Alfred Marshall with offer curve analysis
c. John Stuart Mill with the theory of reciprocal demand
d. Adam Smith with the theory of absolute advantage

Output possibilities for South Korea and Japan

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

____ 31. Refer to the table above. With international trade, what would be the maximum amount of steel that South Korea would be willing to pay in exchange for each Japanese VCR?

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

____ 32. A tariff on imports of product X generally _____ domestic producers of product X and ____ domestic consumers of imports product X.

a. Hurts; helps
b. Helps; helps
c. Hurts, hurts
d. Helps; hurts

____ 33. Suppose country A has abundant labor and scarce capital. Product L requires labor intensive production. Product K requires capital intensive production. A result of open trade according to comparative advantages,

a. The price of capital will decrease in country A
b. The price of Product K will increase in country A
c. Wages will decrease in country A
d. The price of Product L will decrease in country A

____ 34. The table below shows the productivity of 1 unit of labor in the production of corn and autos for Country A and the ROW. Assume that production is characterized by constant costs. In this example trade could benefit both countries if

Productivity of 1 unit of Labor

	Country A	ROW
Corn	60	15
Autos	20	15

a. Country A specialized in corn, the ROW specialized in autos, and trade occurred at a trading price of 1 auto = 2 corn
b. Country A specialized in corn, the ROW specialized in autos and trade occurred at a trading price of 1 auto = 3/4 corn
c. Country A specialized in autos, the ROW specialized in corn and trade occurred at a trading price of 1 auto = 4 corn
d. Country A specialized in corn, the ROW specialized in autos and trade occurred at a trading price of 1 auto = 1/2 corn

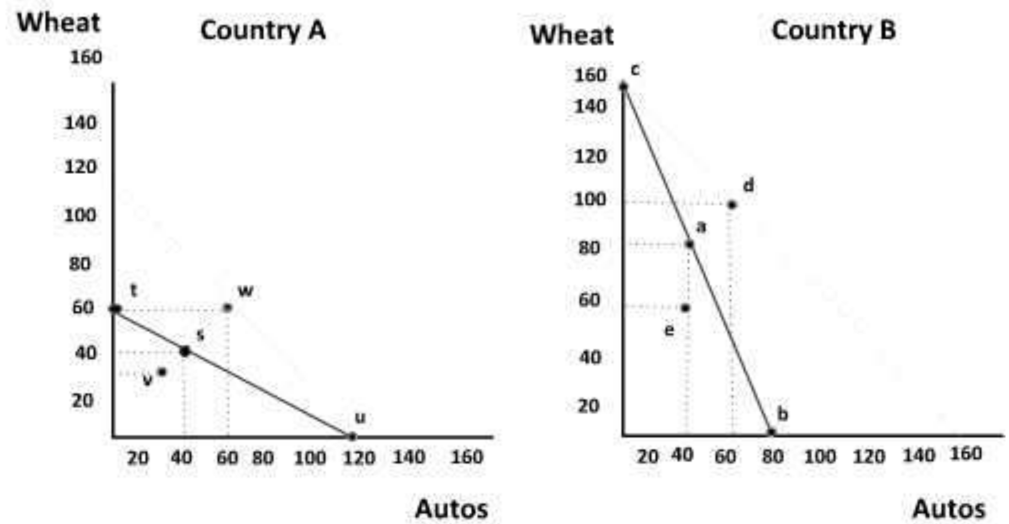
____ 35. In this example the US is abundantly supplied with agricultural land. The supply of unskilled labor is relatively scarce in the US.
The rest of the world (ROW) has abundant unskilled labor but has a relatively scarce supply of land.
Wheat requires land intensive production.
Cloth requires labor intensive production.
As a result of opening of trade between the US and the ROW according to the predictions of the Heckscher Ohlin Theory and the theory of factor price equalization
a. The price of land in the US will increase
b. The price of wheat in the ROW will increase
c. The price of cloth in the US will increase
d. The price of labor in the US will increase

____ 36. According to Bastiat's "Petition of the Candle Makers', the French government was asked to pass legislation restricting the import of a low cost foreign competitor because of unfair competition. The argument was that this barrier to entry would save jobs in the French candle industry. In this petition, the cheap foreign competitor was
a. The sun
b. Light bulb manufacturers in the US
c. German candle makers
d. A sleep aid imported from Brazil

____ 37. Unlike the mercantilists, Adam Smith maintained that:
a. Trade benefits one nation only at the expense of another nation
b. All nations can gain from free international trade
c. Government control of trade leads to maximum economic welfare
d. The world's output of goods must remain constant over time

____ 38. One difference between an import tariff and an import quota for small Country A is that if the world price were to decrease (due to an increase in world supply), under a tariff, Country A's imports will _______while under a quota, Country A's imports will_________.
a. Stay the same; decrease
b. Decrease; increase
c. Stay the same; increase
d. increase; stay the same

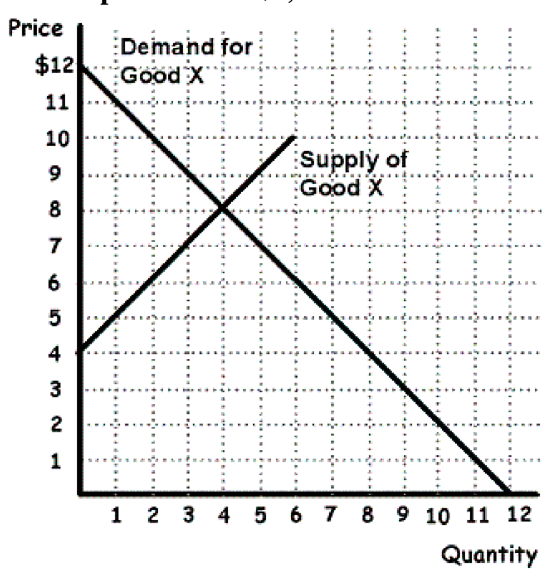
____ 39.



The graphs above show the production possibilities curves for two countries (Country A and Country B) both producing two products (wheat and autos) with constant costs. Originally there is no trade and country A produces and consumes at point s on their PP curve. Country B produces and consumes at point a on their PP curve. Each country then specializes according to their respective comparative advantages and trade 60 autos for 60 wheat. As a result c

a. Country **A** produces at point___t__and consumes at point ___w__.
b. Country **A** produces at point___u__and consumes at point ___w__.
c. Country **B** produces at point ___c__and consumes at point __e___
d. Country **B** produces at point ___b__and consumes at point __e___

____ 40. Consider the domestic demand and supply shown below for **small** country A. The **world price is $5**. If there is an **import tariff = $3**,



a. The consumption effect will be$0
b. The protection effect will be $4.50
c. The deadweight loss from the tariff will be $0
d. Government total tariff revenue will be $4