

Study Questions

Lecture 3 Comparative Advantage and the Gains from Trade

Part 1: Multiple Choice

Select the **best** answer of those given.

1. According to the theory of comparative advantage, which of the following is **not** a reason why countries trade?
 - a. Comparative advantage.
 - b. Costs are higher in one country than in another.
 - c. Prices are lower in one country than in another.
 - d. The productivity of labor differs across countries and industries.
 - e. Exports give a country a political advantage over other countries that export less.

2. Which of the following statements would a mercantilist **not** agree with?
 - a. Imports are desirable.
 - b. Trade is a zero-sum activity.
 - c. The purpose of trade is to amass revenues from exports.
 - d. A country can benefit by granting monopoly rights to individuals.
 - e. Policies should promote exports and discourage imports.

3. If all prices in one country (country A) are higher than all prices in another country (B) when compared at the wage rates that happen to prevail in the two countries, and if the countries share the same currency, then if the nominal wage rate in country B remains fixed
 - a. The nominal wage rate in country A will have to fall.
 - b. Unemployment must be higher in country B than in country A.
 - c. The real wage in country A must be higher than in country B.
 - d. Workers in country A must be less productive than workers in country B.
 - e. Trade cannot be beneficial for country A.

4. According to the theory of comparative advantage, a country will export a good only if
- It can produce it using less labor than other countries.
 - Its productivity is higher in producing the good than the productivity of other countries in producing it.
 - Its wage rate in producing the good is lower than in other countries.
 - Its cost of producing the good, relative to other goods, is at least as low as in other countries.
 - All of the above.

5. Suppose that Austria and Belgium have the unit labor requirements for producing steel and brooms shown in the table at the right. Then

Unit labor requirements		Country	
		Austria	Belgium
Good	Steel	3	8
	Brooms	2	1

- Belgium has a comparative advantage in brooms.
- Austria has a comparative advantage in steel.
- Austria has an absolute advantage in steel.
- Belgium has an absolute advantage in brooms.
- All of the above.

6. Suppose that Australia and Brazil have the outputs per worker in producing sleds and clarinets shown in the table at the right. Then Brazil has a

Output per worker		Country	
		Australia	Brazil
Good	Sleds	300	200
	Clarinets	2	1

- Comparative advantage in sleds.
 - Comparative advantage in clarinets.
 - Absolute advantage in sleds.
 - Absolute advantage in clarinets.
 - None of the above.
7. According to the theory of comparative advantage, countries gain from trade because
- Trade makes firms behave more competitively, reducing their market power.
 - All firms can take advantage of cheap labor.
 - Output per worker in each firm increases.
 - World output can rise when each country specializes in what it does relatively best.
 - Every country has an absolute advantage in producing something.

8. If international trade takes place as a result of comparative advantage, it will cause which of the following effects in the participating countries?
- Inequality among households will be reduced.
 - All individuals in each country will be better off.
 - The average well-being of people in both countries will increase.
 - Both countries will grow faster over time.
 - All of the above.
9. Scholars at MIT recently tested the theory of comparative advantage. One problem with doing this is that
- The theory was never meant to apply after the 19th century.
 - One cannot observe productivity in industries that are not producing.
 - Countries keep their data on international trade secret.
 - The theory is only valid if the world really only produces two goods.
 - The theory turned out to be incorrect.
10. Clyde Prestowitz, in his assigned reading, cites a study that measures various costs of US trade with China. Which of the following is *not* one of those costs?
- Unemployment compensation paid by government
 - The income lost by workers who become unemployed
 - Food stamps
 - Lost tax receipts
 - School budgets

Part II: Short Answer

Answer in the space provided.

- Define the following terms:
 - Trade Adjustment Assistance:
 - Opportunity cost: