- Test 1 is scheduled for Wednesday, March 3rd.
- Test 1 has 40 multiple choice questions.
- Test 1 will cover the material assigned during weeks 1-7. This includes
  - Text: Chapters 2, 3, 4, 5, and 8
  - Aplia assignments for weeks 1-7
- Suggested Study Plan
  - The Aplia week 7 assignment is a graded review intended to help students prepare for test 1. Pay particular attention to this assignment.
  - Review the list of concepts listed below to make sure you haven’t missed something.
  - Go through the sample multiple choice questions listed below.
- Here is a list of concepts that students need to understand
  - Consumer Surplus
  - Producer Surplus
  - Gains from Trade
  - Mercantilism
  - Absolute Advantage
  - Comparative Advantage
  - Heckscher-Ohlin Theory
  - Labor Abundance
  - Labor Intensive production
  - Factor Price Equalization
  - Effects of Trade Opening
  - Intra Industry Trade
  - Product Differentiation
  - Economies of Scale
  - Consumption Effect
  - Protection (production effect)
  - Tariff
  - Ad Valorem Tariff
  - Terms of Trade Effect
  - Small Nation Model
  - Large Nation Model
  - Nationally Optimal Tariff
  - Import Quota
  - Export Tax
  - Export Subsidy
Selected sample multiple choice questions.

1. According to Mercantilist thinking
   a) One goal of trade is for exports to be greater than imports
   b) Trade should be balanced with exports equaling imports
   c) Trade results in the exploitation of poor countries
   d) Trade results in a more equal distribution of income

2. 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) 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

3. Under free trade, the U.S. can import a calculator from Mexico for $20 or from China for $18. Initially, the U.S. has a $3 tariff on all imported calculators. Under this arrangement the US imports 1000 calculators from China and no calculators from Mexico. The (after tariff) price in the US is $21 for calculators imported from China. Then Mexico and the US formed a free trade area (customs union) eliminating tariffs between each other, but maintaining previous tariffs with other countries. As a result, the US imported 1200 calculators from Mexico (at $20) and imported no calculators from China. With the customs union,
   a) The trade creation effect will be $0
   b) The trade creation effect will be $2000
   c) The trade diversion effect will be $0
   d) The trade diversion effect will be $2000

4. According to the theory of comparative advantage, the gains from trade are
   a) The result of an increase in product variety
   b) The result of increasing average labor productivity
   c) The result of reduced taxes
   d) The result of reduced unemployment

5. Refer to the table above. The opportunity cost of one unit of cloth in Country A is
   a) .5 units of wheat
   b) 1 unit of wheat
   c) 1.5 units of wheat
   d) 2 units of wheat

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<th>Productivity of 1 unit of Labor</th>
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<td>Country A</td>
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<td>Wheat</td>
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<td>Cloth</td>
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6. Refer to the table above. Country A has an absolute advantage
   a) In neither good
   b) In both goods
   c) In wheat but not cloth
   d) In cloth but not wheat

7. Refer to the table above. Country B has an comparative advantage
   a) In cloth but not wheat
   b) In both goods
   c) In wheat but not cloth
   d) In neither good

8. As a result of the opening of trade, Firm A is able to sell more products and its average total cost declines. This is an example of
   a) Ricardian comparative advantage
   b) The gains from trade coming from economies of scale
   c) The Leontief paradox
   d) The Heckscher-Ohlin theory

9. Country A exports pharmaceuticals to country B and it imports pharmaceuticals from country B. This is an example of
   a) Trade based on the fairness doctrine
   b) Trade based on factor endowments
   c) Dumping
   d) Intra industry trade

10. Suppose country A has abundant labor and scarce capital. Product L requires labor intensive production. Product K requires capital intensive production. As trade opens then according to the Heckscher Ohlin theory
    a) Country A will export product L
    b) Country A will export product K
    c) The price of product L in country A will decrease
    d) The price of product K in country A will increase

11. Suppose country A has abundant labor and scarce capital. Product L requires labor intensive production. Product K requires capital intensive production. As trade opens
    a) The demand for labor in country A will increase
    b) The demand for capital in country A will increase
    c) The demand for labor in country B will increase
    d) The demand for capital in country A will decrease

12. According to the factor price equalization theorem with free trade
    a) If factor prices are not equal then factors will migrate across borders
    b) If factor prices are not equal then firms will adjust production techniques
    c) Trade will result in a convergence of factor prices across borders
    d) Trade is a substitute for labor migration
13. The difference between a trade model based on the “small nation assumption” (SNA) and a trade model based on the “large nation assumption” (LNA) is
   a) SNA assumes that a tariff will not affect the domestic price while the LNA assumes that it will
   b) The domestic demand curve is vertical for the SCA while it is downward sloping for the LNA
   c) Trading by a “small nation” doesn’t affect the world price, trading by a “large” nation does
   d) Under the SNA trading doesn’t affect the profits of domestic firms while under the LNA it does

14. Consider the domestic demand and supply shown above for small country A. The world price is $4. If there is free trade, consumer surplus in country A will be
   a) $0
   b) $8
   c) $16
   d) $32

15. Consider the domestic demand and supply shown above for small country A. The world price is $4. If there is an import quota = 4 units, the price in country A will be
   a) $5
   b) $6
   c) $7
   d) $8

16. Consider the domestic demand and supply shown above for small country A. The world price is $4. If there is an import tariff = $2, the total government tariff revenue (tariff rate times quantity imported) in will be
   a) $2
   b) $4
   c) $6
   d) $8
17. 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 _______. under a quota, Country A’s imports will_______.
a) Increase; stay the same  
b) Decrease; increase  
c) Stay the same; increase  
d) Stay the same; decrease

18. Under the US sugar import quota
   a) The US price of sugar has been held below the world price and this has led to an increase in US sugar consumption
   b) The low price of US sugar threatens the Brazilian ethanol industry
   c) The US government collects revenue by auctioning the rights to import sugar to the US market
   d) The quota system maintains high domestic sugar prices by restricting the quantity of sugar that can be imported to the US

19. Suppose the US 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 no trade between the US and ROW
   a) Autos would be relatively expensive in the US
   b) Capital would be relatively expensive in the US
   c) Labor would be relatively expensive in the ROW
   d) Shoes would be relatively expensive in the US

20. In the example above, if trade opened between the US and the ROW, then according to the Heckscher Ohlin model,
   a) The price of autos in the US would decrease
   b) The price of capital used to produce autos in the US would decrease
   c) The wages of labor used to produce shoes in the ROW would increase
   d) The price of capital used to produce autos in the ROW would increase

21. In the example above, if trade opened between the US and the ROW, then according to the Heckscher Ohlin model,
   a) The price of autos in the US would increase and the price of autos in the ROW would decrease
   b) The price of labor in the US would increase and the price of labor in the ROW would decrease
   c) The price of labor in the US would increase and the price of labor in the ROW would increase
   d) The price of capital in the US would increase and the price of capital in the ROW would increase

22. If the US is a capital abundant country and Cuba is a labor abundant country then, according to the Heckscher Ohlin theory and factor price equalization theorem, the opening of trade between the US and Cuba should
   a) Create a deadweight loss
   b) Make the US better off and Cuba worse off
   c) Increase the wages of workers in both countries
   d) Raise the price of capital in the US and raise the wages in Cuba
23. According to the Heckscher Ohlin theory, the opening of trade between two countries will make both countries better off but the losers from trade will be
   a) The owners of capital in the capital abundant country
   b) The owners of capital in the labor abundant country
   c) The consumers in both countries
   d) The producers in both countries

24. The theory of comparative advantage and the Heckscher Ohlin model predict that trade will be greatest between
   a) Countries that are geographically close to each other
   b) Countries with similar incomes and consumer preferences
   c) Countries that have high incomes
   d) Labor abundant countries and capital abundant countries

25. In the intra industry trade model trade occurs
   a) To take advantage of differences in wage rates
   b) In markets with scale economies and a “taste for variety”
   c) For commodities that are homogeneous (little differentiation)
   d) As a result of absolute advantage
26. The figure above shows the market for good x in the small country, Zimbania. The world price is $5. If Zimbania has an import tariff of $2, the protection (production) effect will be $_________, and the consumption effect will be $_________.
   a) Protection effect = $0; Consumption Effect = $0
   b) Protection effect = $1; Consumption Effect = $1
   c) Protection effect = $2; Consumption Effect = $0
   d) Protection effect = $2; Consumption Effect = $2

27. The figure above shows the market for good x in the small country, Zimbania. The world price is $5. If Zimbania has an import quota of 2 units, the protection (production) effect will be $_________, and the consumption effect will be $_________.
   a) Protection effect = $0; Consumption Effect = $0
   b) Protection effect = $1; Consumption Effect = $1
   c) Protection effect = $2; Consumption Effect = $0
   d) Protection effect = $2; Consumption Effect = $2

28. The figure above shows the market for good x in the small country, Zimbania. The world price is $5. If Zimbania has a $2 per unit subsidy for domestic producers, the protection (production) effect will be $_________, and the consumption effect will be $_________.
   a) Protection effect = $0; Consumption Effect = $0
   b) Protection effect = $1; Consumption Effect = $1
   c) Protection effect = $2; Consumption Effect = $0
   d) Protection effect = $2; Consumption Effect = $2
29. An export subsidy imposed by a large country can be more damaging to national welfare than an export subsidy imposed by a small country because:
   a) The protection effect is larger for the large country.
   b) The consumption effect is larger for the large country.
   c) The terms of trade worsen for the large country but not for the small country.
   d) Export subsidies are more damaging to a small country than a large country.

30. Refer to the diagram above. **Country Z is a large country.** Initially the world price is $2. Country Z imposes a $2 per unit tariff. Because Country Z decreases its imports, the **world price falls to $1**. One impact of the tariff is:
   a) The terms of trade effect is equal to the size of the area \{K+L\}.
   b) The consumption effect is equal to the size of the area \{E+F\}.
   c) The protection effect is equal to the size of the area \{E+F\}.
   d) Government tariff revenue is equal to the size of the area \{K+L\}.

31. Intraindustry trade can be partly explained by
   a. The Heckscher Ohlin factor abundance theory
   b. The factor price equalization theorem
   c. Economies of scale in production
   d. Increasing opportunity costs
32. Zinhai is a small, exporting country in the world rice market. Recently the world price of rice increased from $500/metric ton to $1000/metric ton. Due to domestic protests about the rising price of rice, the Zinhai government imposed a ban on all exports. All domestic production would now be sold to domestic consumers. As a result of this ban on Zinhai exports
   a) The domestic price of rice in Zinhai will increase
   b) Domestic production of rice in Zinhai will decrease
   c) Domestic consumption of rice in Zinhai will decrease
   d) Domestic consumer surplus of rice consumers in Zinhai will decrease

33. A small country imports T-shirts. With free trade at a world price of $10, domestic production is 10 million T-shirts and domestic consumption is 40 million T-shirts. The country's government now considers two policies to protect their domestic T-shirt producers
   - An import quota to limit T-shirt imports to 10 million per year. With the import quota in place, the domestic price rises to $12 per T-shirt and domestic production rises to 20 million T-shirts. The import licenses are auctioned, bringing in revenue to the government.
   - An import tariff of $2 per unit. This would also raise the domestic price to $12
   Both policies will cause a net loss in total national welfare, with magnitudes equal to approximately (assume linear demand and supply curves)
   a. quota; $20 million tariff: $20 million
   b. quota: $10 million tariff: $40 million
   c. quota: $40 million tariff: $20 million
   d. quota $40 million tariff: $40 million

34. Neuwelt is a small country. Currently Neuwelt produces good X. Some of the production is consumed domestically and some of it is exported at the world price ($9). There is a $4 import tariff on good X in Neuwelt, but since Neuwelt doesn’t import any good X there is no tariff revenue. If the Neuwelt government offered an export subsidy equal to $4 per unit exported.
   a) Domestic consumption of good X will decrease
   b) Consumer surplus in Neuwelt will increase
   c) The consumption effect of the subsidy will be zero
   d) The world price of good X will decrease
35. The US is a large country in the world oil market. The table below shows quantities of oil (in millions of barrels per day) for different prices. Currently the price of oil is $100 per barrel. If the US places a $50 per barrel import tariff on oil, the world price will decrease to $80, the US price would be $130 and the US would import 12 rather than 14 million barrels per day (mbd).

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<th>Q demanded US</th>
<th>Q Imported US</th>
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<td>$100</td>
<td>6 mbd</td>
<td>20 mbd</td>
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<td>$130</td>
<td>7 mbd</td>
<td>19 mbd</td>
<td>12 mbd</td>
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a. The terms of trade effect would be about $100 million per day  
b. The protection (production) effect would be $0 million per day  
c. The consumption effect would be about $1 million per day  
d. US producer surplus would increase by about $195 million per day

36. If two countries specialize according to their respective comparative advantages and then trade at mutually agreed upon terms of trade then both counties will end up

a) With a consumption bundle of goods at one of the end points of their production possibilities curve  
b) Consuming bundles of goods that lie outside their own production possibilities curve  
c) At the midpoint of their respective production possibilities curves  
d) Exporting only those products for which they have an absolute advantage
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