

International Economics, 8e (Krugman)

Chapter 1 Introduction

1.1 What Is International Economics About?

1) Historians of economic thought often describe _____ written by _____ and published in _____ as the first real exposition of an economic model.

- A) "Of the Balance of Trade," David Hume, 1776
- B) "Wealth of Nations," David Hume, 1758
- C) "Wealth of Nations," Adam Smith, 1758
- D) "Wealth of Nations," Adam Smith, 1776
- E) "Of the Balance of Trade," David Hume, 1758

Answer: E

Question Status: Previous Edition

2) From 1959 to 2004,

- A) the U.S. economy roughly tripled in size.
- B) U.S. imports roughly tripled in size.
- C) the share of US Trade in the economy roughly tripled in size.
- D) U.S. Imports roughly tripled as compared to U.S. exports.
- E) U.S. exports roughly tripled in size.

Answer: C

Question Status: Previous Edition

3) The United States is less dependent on trade than most other countries because

- A) the United States is a relatively large country.
- B) the United States is a "Superpower."
- C) the military power of the United States makes it less dependent on anything.
- D) the United States invests in many other countries.
- E) many countries invest in the United States.

Answer: A

Question Status: Previous Edition

4) Ancient theories of international economics from the 18th and 19th Centuries are

- A) not relevant to current policy analysis.
- B) are only of moderate relevance in today's modern international economy.
- C) are highly relevant in today's modern international economy.
- D) are the only theories that actually relevant to modern international economy.
- E) are not well understood by modern mathematically oriented theorists.

Answer: C

Question Status: Previous Edition

5) An important insight of international trade theory is that when countries exchange goods and services one with the other it

- A) is always beneficial to both countries.
- B) is usually beneficial to both countries.
- C) is typically beneficial only to the low wage trade partner country.
- D) is typically harmful to the technologically lagging country.
- E) tends to create unemployment in both countries.

Answer: B

Question Status: Previous Edition

- 6) If there are large disparities in wage levels between countries, then
- A) trade is likely to be harmful to both countries.
 - B) trade is likely to be harmful to the country with the high wages.
 - C) trade is likely to be harmful to the country with the low wages.
 - D) trade is likely to be harmful to neither country.
 - E) trade is likely to have no effect on either country.

Answer: D

Question Status: Previous Edition

- 7) Benefits of international trade are limited to
- A) tangible goods.
 - B) intangible goods.
 - C) all goods but not services.
 - D) services.
 - E) None of the above.

Answer: E

Question Status: Previous Edition

- 8) Which of the following does not belong?
- A) NAFTA
 - B) Uruguay Round
 - C) World Trade Organization
 - D) None Tariff Barriers
 - E) None of the above.

Answer: D

Question Status: Previous Edition

- 9) International economics does not use the same fundamental methods of analysis as other branches of economics, because
- A) the level of complexity of international issues is unique.
 - B) the interactions associated with international economic relations is highly mathematical.
 - C) international economics takes a different perspective on economic issues.
 - D) international economic policy requires cooperation with other countries.
 - E) None of the above.

Answer: E

Question Status: New

- 10) Because the Constitution forbids restraints on interstate trade,
- A) the U.S. may not impose tariffs on imports from NAFTA countries.
 - B) the U.S. may not affect the international value of the \$ U.S.
 - C) the U.S. may not put restraints on foreign investments in California if it involves a financial intermediary in New York State.
 - D) the U.S. may not impose export duties.
 - E) None of the above

Answer: E

Question Status: New

11) Which of the following is not a major concern of international economic theory?

- A) protectionism
- B) the balance of payments
- C) exchange rate determination
- D) Bilateral trade relations with China
- E) None of the above

Answer: D

Question Status: New

12) "Trade is generally harmful if there are large disparities between countries in wages."

- A) This is generally true.
- B) This is generally false.
- C) Trade theory has nothing to say about this issue.
- D) This is true if the trade partner ignores child labor laws.
- E) This is true if the trade partner uses prison labor.

Answer: B

Question Status: New

13) Who sells what to whom

- A) has been a major preoccupation of international economics.
- B) is not a valid concern of international economics.
- C) is not considered important for government foreign trade policy since such decisions are made in the private competitive market.
- D) is determined by political rather than economic factors.
- E) None of the above

Answer: A

Question Status: New

14) The insight that patterns of trade are primarily determined by international differences in labor productivity was first proposed by

- A) Adam Smith.
- B) David Hume.
- C) David Ricardo.
- D) Eli Heckscher.
- E) Lerner and Samuelson.

Answer: C

Question Status: New

15) Since the mid 1940s, the United States, has pursued a broad policy of

- A) strengthening "Fortress America" protectionism.
- B) removing barriers to international trade.
- C) isolating Iran and other axes of evil.
- D) protecting the U.S. from the economic impact of oil producers.
- E) None of the above.

Answer: B

Question Status: New

- 16) The balance of payments has become a central issue for the United States because
- A) when the balance of payments is not balanced, society is unbalanced.
 - B) the U.S. economy cannot grow when the balance of payments is in deficit.
 - C) the U.S. has run huge trade deficits in every year since 1982.
 - D) the U.S. never experienced a surplus in its balance of payments.
 - E) None of the above.

Answer: C

Question Status: New

- 17) The euro, a common currency for most of the nations of Western Europe, was introduced
- A) before 1900.
 - B) before 1990.
 - C) before 2000.
 - D) in order to snub the pride of the U.S.
 - E) None of the above.

Answer: C

Question Status: New

- 18) During the first three years of its existence, the euro
- A) depreciated against the \$U.S.
 - B) maintained a strict parity with the \$U.S.
 - C) strengthened against the \$U.S.
 - D) proved to be an impossible dream.
 - E) None of the above.

Answer: A

Question Status: New

- 19) The study of exchange rate determination is a relatively new part of international economics, since,
- A) for much of the past century, exchange rates were fixed by government action.
 - B) the calculations required for this were not possible before modern computers became available.
 - C) economic theory developed by David Hume demonstrated that real exchange rates remain fixed over time.
 - D) dynamic overshooting asset pricing models are a recent theoretical development.
 - E) None of the above

Answer: A

Question Status: New

- 20) A fundamental problem in international economics is how to produce
- A) a perfect degree of monetary harmony.
 - B) an acceptable degree of harmony among the international trade policies of different countries.
 - C) a world government that can harmonize trade and monetary policies
 - D) a counter-cyclical monetary policy so that all countries will not be adversely affected by a financial crisis in one country.
 - E) None of the above.

Answer: B

Question Status: New

- 21) For the 50 years preceding 1994, international trade policies have been governed
- A) by the World Trade Organization.
 - B) by the International Monetary Fund.
 - C) by the World.
 - D) by an international treaty known as the General Agreement on Tariffs and Trade (GATT).
 - E) None of the above.

Answer: D

Question Status: New

- 22) The international capital market is
- A) the place where you can rent earth moving equipment anywhere in the world.
 - B) a set of arrangements by which individuals and firms exchange money now for promises to pay in the future.
 - C) the arrangement where banks build up their capital by borrowing from the Central Bank.
 - D) the place where emerging economies accept capital invested by banks.
 - E) None of the above.

Answer: B

Question Status: New

- 23) International capital markets experience a kind of risk not faced in domestic capital markets, namely
- A) "economic meltdown" risk.
 - B) Flood and hurricane crisis risk.
 - C) the risk of unexpected downgrading of assets by Standard and Poor.
 - D) exchange rate risk.
 - E) None of the above.

Answer: D

Question Status: New

- 24) Since 1994, trade rules have been enforced by
- A) the WTO.
 - B) the G10.
 - C) the GATT.
 - D) The U.S. Congress.
 - E) None of the above.

Answer: A

Question Status: New

- 25) In 1998 an economic and financial crisis in South Korea caused it to experience
- A) a surplus in their balance of payments.
 - B) a deficit in their balance of payments.
 - C) a balanced balance of payments.
 - D) an unbalanced balance of payments.
 - E) None of the above.

Answer: A

Question Status: New

- 26) In 1999, demonstrators representing a mix of traditional and new ideologies disrupted a major international trade meeting in Seattle of
- A) the OECD.
 - B) NAFTA.
 - C) WTO.
 - D) GATT.
 - E) None of the above.

Answer: C

Question Status: New

- 27) International Economists cannot discuss the effects of international trade or recommend changes in government policies toward trade with any confidence unless they know
- A) their theory is the best available.
 - B) their theory is internally consistent.
 - C) their theory passes the "reasonable person" legal criteria.
 - D) their theory is good enough to explain the international trade that is actually observed.
 - E) None of the above.

Answer: D

Question Status: New

- 28) Trade theorists have proven that the gains from trade
- A) must raise the economic welfare of every country engaged in trade.
 - B) must raise the economic welfare of everyone in every country engaged in trade.
 - C) must harm owners of "specific" factors of production.
 - D) will always help "winners" by an amount exceeding the losses of "losers."
 - E) None of the above.

Answer: E

Question Status: New

1.2 International Economics: Trade and Money

- 1) Cost-benefit analysis of international trade
- A) is basically useless.
 - B) is empirically intractable.
 - C) focuses attention primarily on conflicts of interest within countries.
 - D) focuses attention on conflicts of interests between countries.
 - E) None of the above.

Answer: C

Question Status: Previous Edition

- 2) An improvement in a country's balance of payments means a decrease in its balance of payments deficit, or an increase in its surplus. In fact we know that a surplus in a balance of payments
- A) is good.
 - B) is usually good.
 - C) is probably good.
 - D) may be considered bad.
 - E) is always bad.

Answer: D

Question Status: Previous Edition

- 3) The GATT was
- A) an international treaty.
 - B) an international U.N. agency.
 - C) an international IMF agency.
 - D) a U.S. government agency.
 - E) a collection of tariffs.

Answer: A

Question Status: Previous Edition

- 4) The international debt crisis of early 1982 was precipitated when _____ could not pay its international debts.
- A) Russia
 - B) Mexico
 - C) Brazil
 - D) Malaysia
 - E) China

Answer: B

Question Status: Previous Edition

- 5) International economics can be divided into two broad sub-fields
- A) macro and micro.
 - B) developed and less developed.
 - C) monetary and barter.
 - D) international trade and international money.
 - E) static and dynamic.

Answer: D

Question Status: Previous Edition

- 6) International monetary analysis focuses on
- A) the real side of the international economy.
 - B) the international trade side of the international economy.
 - C) the international investment side of the international economy.
 - D) the issues of international cooperation between Central Banks.
 - E) None of the above.

Answer: E

Question Status: New

- 7) The distinction between international trade and international money is not useful since
- A) real developments in the trade accounts have monetary implications.
 - B) the balance of payments includes both real and financial implications.
 - C) developments caused by purely monetary changes have real effects.
 - D) trade models focus on real, or barter relationships.
 - E) None of the above.

Answer: E

Question Status: New

8) It is argued that small countries tend have more open economies than large ones. Is this empirically verified? What are the logical underpinnings of this argument?

Answer: Yes. They do not have sufficient resources to satisfy consumption needs; and also do not have a sufficiently large market to enable their industries to avail themselves of scale economy possibilities. Another answer would rely on a location argument. Assume that the "natural" market for any given plant is a circle with a radius of n miles with the plant at its center. Assuming that the production plants are located randomly throughout the country, then the probability that the typical circular market will encompass some foreign country is greater the smaller is the country.

Question Status: Previous Edition

9) It is argued that if a rich high wage country such as the United States were to expand trade with a relatively poor and low wage country such as Mexico, then U.S. industry would migrate south, and U.S. wages would fall to the level of Mexico's. What do you think about this argument?

Answer: The student may think anything. The purpose of the question is to set up a discussion, which will lead to the models in the following chapters.

Question Status: Previous Edition

10) Some patterns of international trade are easier to explain than others. Give several examples and explain.

Answer: Historical circumstance can explain some patterns such as the relatively large trade flows from West Africa to France. The relatively sparse trade between countries within South America seems curious.

Question Status: Previous Edition

11) International trade tends to prove that international trade is beneficial to all trading countries. However, casual observation notes that official obstruction of international trade flows is widespread. How might you reconcile these two facts?

Answer: This question is meant to allow students to offer preliminary discussions of issues, which will be explored in depth later in the book.

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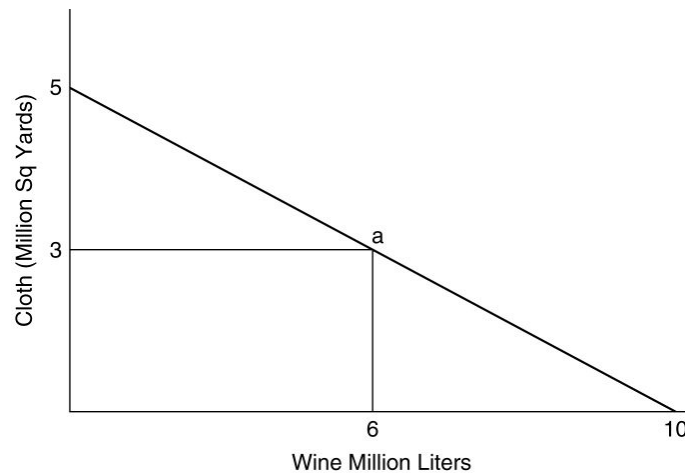
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Question Status: Previous Edition

16) International Trade theory is one of the oldest areas of applied economic policy analysis. It is also an area for which data was relatively widely available very early on. Why do you suppose this is the case?

Answer: In ancient times, public finance was not well developed. Most of the population was not producing and consuming within well-developed market economies, so that income and sales taxes were not efficient. One of the most convenient ways for governments to obtain resources was to set up custom posts at borders and tax. Hence international trade was of great policy interest to princes and kings, as was precise data of their main tax base.

Question Status: Previous Edition



17) The figure above is the Production Possibility Frontier (PPF) of Baccalia, where only two products are produced, clothing and wine. In fact Baccalia is producing on its PPF at point A. By and large the people of Baccalia are content, as both their external and internal needs for warmth are satisfied in the most economically efficient manner possible, given their available productive resources (and known technology). How much wine is being produced? How much cloth? If a person in this country wanted to purchase a liter of wine, what would be the price he or she would have to pay?

Judging from what you learned in the previous paragraph, can you indicate at which point (if at all) the Community Indifference Curve is tangent to the Production Possibility Frontier? Explain your reasoning.

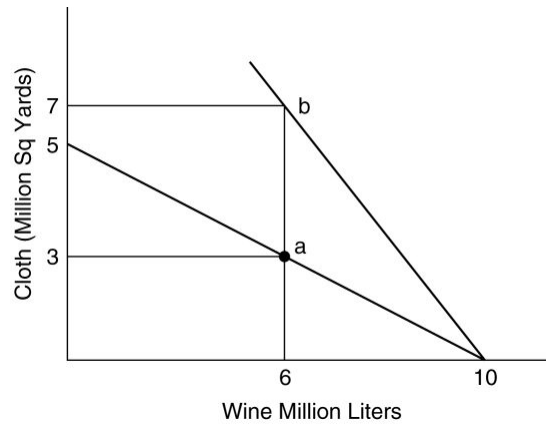
Answer: 6 million liters of wine are being produced.

3 million square yards of cloth are being produced.

The price of 1 liter of wine is one half of a square yard of cloth.

The tangency is at point A. We know this because otherwise the country would not be producing at the point of maximum economic efficiency.

Question Status: Previous Edition



- 18) One day, Baccalia joined the WTO and joined the Global Village. They discovered that in the LWE (London Wine Exchange), 1 liter of wine is worth 1 square yard of cloth. What is the logical production point they should strive for? (See figure.)
 Answer: 10 million liters of wine.
 Question Status: Previous Edition
- 19) Baccalia wishes to enjoy to the fullest from the gains from trade, but is not willing to give up imbibing even one drop of wine from the 6 million liters they consumed in their original autarkic state. If their new consumption point is a point we shall designate as point b, describe where this point would be found. (See figure.)
 Answer: Vertically above point a
 Question Status: Previous Edition
- 20) Where is the Community Indifference Curve family of curves tangent to their new Consumption Possibility Frontier?
 Answer: At point b.
 Question Status: Previous Edition
- 21) How can you prove that Baccalia has in fact gained from the availability of trade, and that their new situation is superior to the pre-trade situation (with which they were quite content)?
 Answer: The country was consuming at point a before trade. It is now consuming at point b with trade. Point b represents a superior welfare combination of goods as compared to point a, since at b the country has more of each of the goods.
 Question Status: Previous Edition