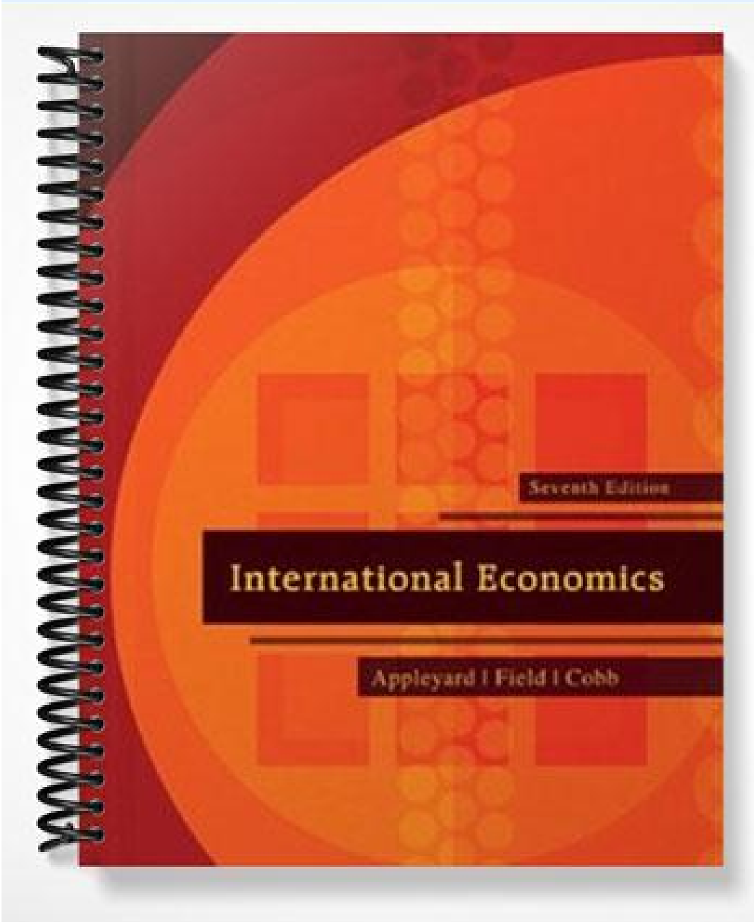
TEST BANK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International Economics
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CHAPTER 2
EARLY TRADE THEORIES:
Mercantilism and the Transition to the Classical World of David Ricardo

A. Essay Questions

1. Explain how the price-specie-flow mechanism operates to maintain balanced trade between countries. What are the assumptions that are critical to the mechanism's successful operation?

2. Why was a positive trade balance so important to Mercantilists? In Mercantilist thinking, why did a positive trade balance not result in domestic inflation and a loss of international competitiveness?

3. What were the critical foundations of Mercantilist thought? What trade policies resulted from this way of thinking?

4. Explain what is meant by a zero-sum game, and why it was central to Mercantilist thinking. Then, explain how Smith's idea of absolute advantage altered the nature of the "game."

5. (a) Why did the Mercantilists think that a situation where a country's exports exceed its imports is a "favorable" situation for the country? Briefly, what policies would a Mercantilist recommend in order to generate such a "favorable" situation?

   (b) What was the "price-specie-flow doctrine" and how did it undermine Mercantilist thinking? Why would a situation where the demands for traded goods are "inelastic" with respect to price changes pose a problem for the "price-specie-flow doctrine" in its attack on Mercantilist thinking?

B. Multiple-Choice Questions

6. In the price-specie-flow doctrine, a deficit country will __________ gold, and this gold flow will ultimately lead to __________ in the deficit country's exports.

   a. lose; a decrease
   * b. lose; an increase
   c. gain; a decrease
   d. gain; an increase

7. In the Mercantilist view of international trade (in a two-country world),

a. both countries could gain from trade at the same time, but the distribution of the gains depended upon the terms of trade.
b. both countries could gain from trade at the same time, and the terms of trade were of no consequence for the distribution of the gains.
c. neither country could ever gain from trade.
* d. one country's gain from trade was associated with a loss for the other country.

8. According to the labor theory of value,

a. the value of labor is determined by its value in production.
b. the value of a good is determined by the amount of labor with which each unit of capital in an industry works.
* c. the price of a good A compared to the price of good B bears the same relationship as the relative amounts of labor used in producing each good.
d. the values of two minerals such as coal and gold with similar production costs may be very different.

9. If the demand for traded goods is price-inelastic, the price-specie-flow mechanism will result in

a. gold movements between countries that remove trade deficits and surpluses.
* b. gold movements between countries that worsen trade deficits and surpluses.
c. negligible movements of gold between countries and hence little or no adjustment of trade deficits and surpluses.
d. a removal of the basis for trade between countries.

10. In Adam Smith's view, international trade

a. benefited both trading countries.
b. was based on absolute cost differences.
c. reflected the resource base of the countries in question.
* d. all of the above.

11. Which of the following policies would *NOT* be consistent with the Mercantilist balance-of-trade doctrine?

* a. payment of high wages to labor
b. import duties on final products
c. export subsidies
d. prohibition of imports of manufactured goods

12. During the price-specie-flow adjustment process to a trade imbalance, if demands for goods are *inelastic*, then, when the price level __________ in the country with the trade deficit, the value of that country's exports will __________ as the price-specie-flow process takes place.

  a. falls; increase
* b. falls; decrease
  c. rises; increase
  d. rises; decrease

13. David Hume's price-specie-flow mechanism

  a. reinforced the Mercantilist notion that a country could maintain a permanent "favorable" balance of trade where exports exceeded imports.
* b. works more effectively if demands for traded goods are "price-elastic" rather than "price-inelastic."
  c. assumed that the countries involved have substantial unemployment.
  d. works equally effectively whether demands for traded goods are "price-elastic" or "price-inelastic."

14. The price-specie-flow mechanism suggested that

  a. a country could easily maintain a balance-of-payments surplus for a long period of time.
  b. a deficit country would experience an increase in its money supply and its price level.
* c. a surplus country would experience an increase in its money supply and its price level.
  d. a country's internal price level has no relation to the country's foreign trade activities.

15. The policy of minimum government interference in or regulation of economic activity, advocated by Adam Smith and the Classical economists, was known as

  a. the law of comparative advantage.
* b. laissez-faire.
  c. the labor theory of value.
  d. Mercantilism.

16. A Mercantilist policymaker would be in favor of which of the following policies or events pertaining to his/her country?

  a. a decrease in the size of the population
  b. a minimum wage bill to protect the standard of living of workers
  c. a prohibition on the export of manufactured goods
* d. an increase in the percentage of factors of production devoted to adding value to imported raw materials in order to later export the resulting manufactured goods.

17. In the context of David Hume's price-specie-flow mechanism that challenged the feasibility of the Mercantilist ideas regarding a trade surplus, which one of the following statements is **NOT** correct?

a. There is a decrease in the money supply in the deficit country.
b. There is an increase in the price level in the surplus country.
* c. There is an increase in real income in the surplus country.
d. Price changes in the surplus country cause that country's exports to decrease.

18. In David Hume's price-specie-flow doctrine or adjustment mechanism, the assumption is made that changes in the money supply have an impact on __________. Further, the demand for traded goods is assumed to be __________ with respect to price.

* a. prices rather than on output; elastic
b. prices rather than on output; inelastic
c. output rather than on prices; elastic
d. output rather than on prices; inelastic

19. The "paradox of Mercantilism" reflected that fact that

a. trade surpluses were fostered by protective tariffs.
* b. rich countries were comprised of large numbers of poor people.
c. gold inflows led to higher prices and reduced exports.
d. gold could not be hoarded and provide money for the economy at the same time.

20. Given the following Classical-type table showing the number of days of labor input required to obtain one unit of output of each of the two commodities in each of the two countries:

	bicycles	computers
United States	4 days	3 days
United Kingdom	5 days	6 days

The United States has an absolute advantage in the production of __________.

a. bicycles (only)
b. computers (only)
* c. both bicycles and computers
d. neither bicycles nor computers

21. With M_S = supply of money, V = velocity of money, P = price level, and Y = real output, which one of the following indicates the quantity theory of money expression?

a. $M_S Y = PV$
b. $M_S P = VY$
c. $M_S = PY - V$
* d. $M_S V = PY$

22. In the price-specie-flow mechanism, there is a gold __________ a country with a balance-of-trade surplus, and this gold flow ultimately leads to __________ in the surplus country's exports.

a. inflow into; an increase
* b. inflow into; a decrease
c. outflow from; an increase
d. outflow from; a decrease

23. In the price-specie-flow adjustment mechanism, a country with a balance-of-trade surplus experiences

a. a gold inflow and a decrease in the price level.
b. a gold outflow and an increase in the money supply.
* c. an increase in the money supply and a decrease in exports.
d. a decrease in the money supply and a decrease in imports.

24. Suppose that country A's total exports are 10,000 units of good X at a price of $20 per unit, meaning that country A's export earnings or receipts are $200,000. Suppose also that the foreign price elasticity of demand for country A's exports of good X is (-) 0.6. If country A's prices for all goods, including its exports, now rise by 10% because of a gold inflow such as in the Mercantilist model, then, other things equal, country A's exports of good X will fall by __________ and country A's export earnings or receipts will become __________.

a. 600 units; less than $200,000
* b. 600 units; greater than $200,000
c. 1,000 units; less than $200,000
d. 1,000 units; greater than $200,000