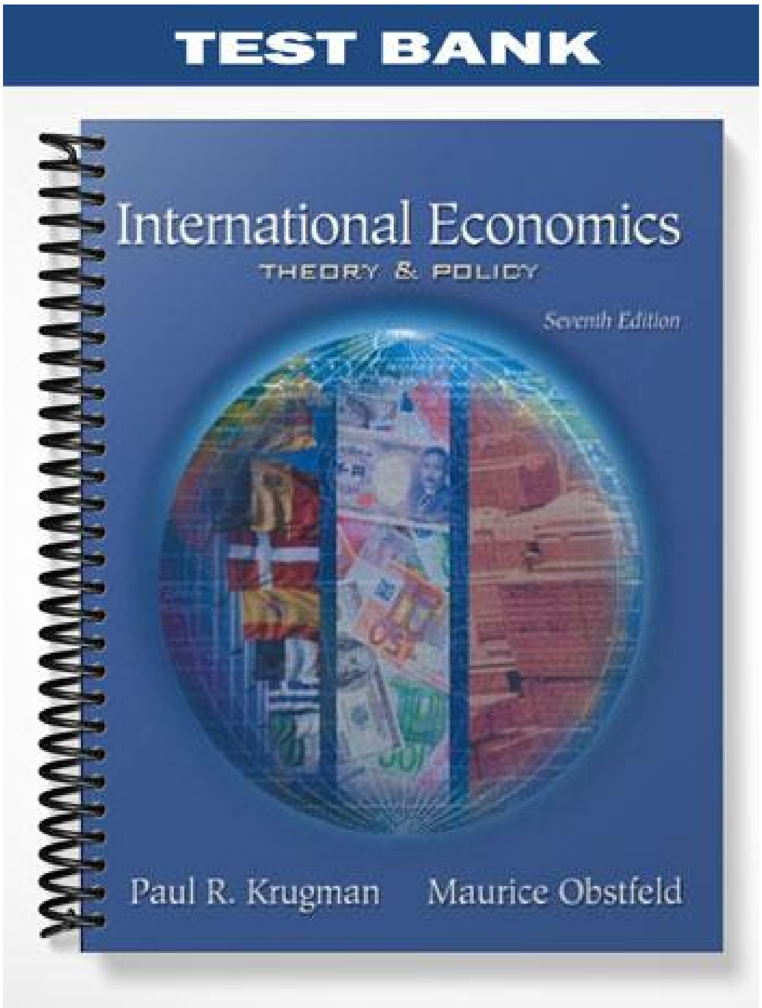
TEST BANK
International Economics
THEORY & POLICY
Seventh Edition
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Chapter 2
World Trade—An Overview

■ Multiple Choice Questions

1. What percent of all world production of goods and services is exported to other countries?
   (a) 10%
   (b) 25%
   (c) 50%
   (d) 100%
   (e) None of the above

   Answer: B

2. What percent of all world imports of goods and services were exported?
   (a) 10%
   (b) 25%
   (c) 50%
   (d) 100%
   (e) None of the above.

   Answer: D

3. What percent of all world consumption (private and public, including real investment) was imported?
   (a) 10%
   (b) 25%
   (c) 50%
   (d) 100%
   (e) None of the above.

   Answer: B

4. The *gravity model,* that states that size matters, predicts that the weight of the traded good will ________ related to its likelihood to be exported
   (a) be directly
   (b) be inversely
   (c) not be
   (d) All of the above
   (e) None of the above

   Answer: E

5. The *gravity model* offers a logical explanation for the fact that
   (a) Trade between Asia and the U.S. has grown faster than NAFTA trade.
   (b) Trade in services has grown faster than trade in goods.
   (c) Trade in manufactures has grown faster than in agricultural products
   (d) Intra-European Union trade exceeds International Trade of the European Union.
   (e) None of the above

   Answer: D

6. The *gravity model* suggests that over time
   (a) trade between neighboring countries will increase
   (b) trade between all countries will increase
   (c) world trade will eventually be swallowed by a *black hole*.
   (d) trade between Earth and other planets will become important
   (e) None of the above

   Answer: E

7. The *gravity model* explains why
   (a) trade between Sweden and Germany exceeds that between Sweden and Spain
   (b) countries with oil reserves tend to export oil.
   (c) capital rich countries export capital intensive products
   (d) intra-industry trade is relatively more important than other forms of trade between neighboring countries.
   (e) None of the above

   Answer: A

8. According to the *gravity model,* a characteristic that tends to affect the probability of trade existing between any two countries is
   (a) their cultural affinity
   (b) the average weight/value of their traded goods
   (c) their colonial—historical ties
   (d) the distance between them
   (e) the number of varieties produced on the average by their industries.

   Answer: D

9. The one single trade partner country of the U.S. is
   (a) United Kingdom
   (b) Canada
   (c) Mexico
   (d) Japan
   (e) Israel

   Answer: B

10. In general which of the following tend to promote the probability of trade volumes between two countries
    (a) Linguistic and/or cultural affinity
    (b) Historical ties
    (c) Sizes of economies
    (d) Mutual membership in preferential trade agreements
    (e) All of the above

    Answer: E

11. Since World War II (the early 1950s), the proportion of most countries' production being used in some other country
    (a) remained constant
    (b) increased
    (c) decreased
    (d) fluctuated widely with no clear trend
    (e) both (a) and (d) above

    Answer: B

12. Since World War II, the likelihood that foreign markets would gain importance in the average exporters' as a source of profits
    (a) remained constant
    (b) increased
    (c) decreased
    (d) fluctuated widely with no clear trend
    (e) both (a) and (d) above

    Answer: B

13. Since World War II, the likelihood that any single item in the typical consumption basket of a consumer in the U.S. originated outside of the U.S.
    (a) remained constant
    (b) increased
    (c) decreased
    (d) fluctuated widely with no clear trend
    (e) both (a) and (d) above

    Answer: B

14. Since World War II, the likelihood that the job a new college graduate will be directly or indirectly affected by world trade
    (a) remained constant
    (b) increased
    (c) decreased
    (d) fluctuated widely with no clear trend
    (e) both (a) and (d) above

    Answer: B

15. Since World War II, the relative importance of raw materials, including oil, in total world trade
    (a) remained constant
    (b) increased
    (c) decreased
    (d) fluctuated widely with no clear trend
    (e) both (a) and (d) above

    Answer: C

16. In the current Post-Industrial economy, international trade in services (including banking and financial services)
    (a) dominates world trade
    (b) does not exist
    (c) is relatively small
    (d) is relatively stagnant
    (e) None of the above

    Answer: C

17. In the pre-World War I period, the U.S. exported primarily
    (a) manufactured goods
    (b) services
    (c) primary products including agricultural
    (d) technology intensive products
    (e) None of the above

    Answer: C

18. In the pre-World War I period, the United Kingdom exported primarily
    (a) manufactured goods
    (b) services
    (c) primary products including agricultural
    (d) technology intensive products
    (e) None of the above

    Answer: A

19. In the pre-World War I period, the United Kingdom imported primarily
    (a) manufactured goods
    (b) services
    (c) primary products including agricultural
    (d) technology intensive products
    (e) None of the above

    Answer: C

20. In the present, most of the exports from China are in
    (a) manufactured goods
    (b) services
    (c) primary products including agricultural
    (d) technology intensive products
    (e) None of the above

    Answer: A

21. Which of the following does **not** explain the extent of trade between Ireland and the U.S.?
    (a) Historical ties
    (b) Cultural Linguistic ties
    (c) *Gravity model*
    (d) Multinational Corporations
    (e) None of the above

    Answer: C

■ Essay Questions

1. When comparing the composition of world trade in the early 20th Century to the early 21st Century, we find major compositional changes. These include a relative decline in agricultural and primary-products (including raw materials). How would you explain this in terms of broad historical developments during this period?

   Answer: The typical composition of world production during this period experienced major changes. Focusing on today's Industrialized Countries (primarily members of the OECD), the industrial-employment composition was focused primarily on agriculture. Most value was in land. The predominant single consumption category was food. Since then, the economies shifted from the agricultural to the manufacturing sectors (continuing trends begun over a century earlier in the industrial revolution). Incomes rose, and consumption shifted in favor of (increasingly affordable) manufactures. Both income and price elasticities were greater in manufactures than in agricultural products. At the same time there was a steady tendency for synthetic (manufactured) inputs to replace agricultural based raw materials and industrial inputs. Hence, trade and of course international trade conformed to overall changes in patterns of world production and consumption.

2. In the past half century, the *developing countries* have experienced major compositional shifts from exports of primary products (including agricultural and raw materials) to exports of manufactures. How might you explain this in terms of broad historical developments during this period?

   Answer: Any discussion of the export experience of the *developing countries* must first clarify the problem of definitional inclusion. In particular, the exports of the (non-OECD) *developing countries,* has become increasingly dominated by the experience of a relatively small number of countries in South-East Asia, termed the *New Industrialized Countries (NICs)*. Since they experienced both very rapid increases in their exports, and very rapid increases in the manufactured component of their exports, their experience alone may explain the bulk of the observed phenomenon. Many would exclude the NICs from the *developing country* category so as to be able to focus the discussion on a more representative sample of (the over 100) developing countries. More recently, a second wave of East Asian countries, notably including China have replicated the experience of the NICs, and this again muddies the water for one interested in focusing on the export experience of the growing heterogenous category, *developing countries.*

Another explanation of the growing dependence on manufactured exports on the part of the *developing countries,* follows the answer to question 1 above. Since the consumer (including industrial consumer) markets in OECD countries were rapidly shifting away from primary products, these markets were rapidly disappearing.

In addition, in the world markets for primary products was generally limited by low price and especially income elasticities; agricultural sectors tended to be highly and rigidly protected in potential OECD markets; and escalating effective tariff structures levied systematically large levels of protection against the primary exports of the *developing countries*; success in world exports had to be pursued outside of the traditional primary exports of these countries.

3. The Neoclassical Heckscher-Ohlin model assumes that all producers of any industrial product has knowledge of, and may avail itself of the same production technology available to producers in any other country. Many have flagged this *identical technology* assumption as an unrealistic assumption. During the past half century, the relative importance of the Multinational Corporations (MNCs) in world trade has steadily increased. How would this trend affect the realism of the "*identical technology*" assumption?

Answer: Noting that MNC plants tend to use more labor intensive production processes in countries where labor tends to be relatively cheap (both in "low" tech , e.g. Nike, and "high tech," e.g. Motorola), one may argue that MNCs use different technologies in *developing countries*. However, this is a gross misunderstanding of the *identical technology* assumption . It is axiomatically obvious that if the same MNC is producing something in both labor abundant and labor scarce using different processes, it nevertheless has knowledge (intimate knowledge in the case of proprietary patented processes) of available technology. The fact that the MNC may choose not to apply the same degree of capital intensity in environments with greatly different relative factor prices in no way lessens the fact that the Heckscher-Ohlin *identical technology* assumption is strengthened due to the growing relative strength of MNCs in developing countries. An additional fact that strengthens this argument is that, as compared to the early 1950s, a growing proportion of MNCs are themselves based in *developing countries,* such as China and Brazil.

4. One of the major political developments of the past several decades is the growing size and economic/monetary integration of the European Union. What effect do you think this will have on international trade between countries?

Answer: The growing economic integration between the various countries of Europe, both the old and existing members of the European Union (EU) and the new countries joining it (including perhaps soon, Turkey), means that the barriers to trade are steadily falling in a region that has traditionally dominated world trade. The common monetary unit should in itself go far to promote inter-country trade within the growing EU (judging by the positive historical effect of a single currency in the U.S.). The standardization of transportation (including railroad gauges, highway signs etc.) and product codes will also promote expansion of intra-EU trade. The decline in the probability of political conflict associated with this comprehensive economic union, plus conscious attempts to cooperate in fiscal and monetary policy stances again point to growing international trade, allowing these countries to increasingly enjoy the fruits of potential positive scale economies, and more traditional classical and neo-classical gains from trade. The scale economies will also tend to increase trade between the EU and other countries.

5. The Services sector has been steadily rising in relative importance in GDP of the United States, as well as elsewhere around the world. Since “services” have been identified as “non-tradables” (e.g. it is difficult to export haircuts), it may be argued that this trend will likely slow the rapid growth in international trade. Discuss.

Answer: This argument stands on questionable logical foundations. The past half century has seen a steady growth in the absolute and relative importance of international trade. This trend has been reversed only by global conflicts, i.e. the two World Wars. This trend has remained steady and robust despite major compositional shifts (e.g. from primary to manufacturing), and location shifts (e.g., the sudden rise of NICs as significant group of exporters). The trend will probably continue into the reasonable future, fueled by both super-regional preferential trade regions and a growing impact of the multilateral forces, represented institutionally by the World Trade Organization (WTO)—as illustrated by the recent abolishment of the epitome cartelized trade, the world trade in textiles. Driven by technology—especially in the areas of communication and transportation—a reversal of the growing trade trend is not likely in the near future. In any case, many “services” are in fact quite tradable. Examples would be financial services, long-distance teaching, “help-desk” outsourcing, consulting and management services and others. In fact, when a tourist gets a haircut, we see that even haircuts become a “tradable” service.