Question #1 of 62

The law of comparative advantage holds that trading partners can be made better off if they:

A) specialize in production of goods for which they are the low exchange rate adjusted producer.

B) import those goods for which they have a comparative advantage.

C) specialize in production of goods for which they are the low opportunity cost producer.

Explanation

The law of comparative advantage holds that trading partners can be made better off if they specialize in production of goods for which they are the low opportunity cost producer. They should export, not import, goods for which they have a comparative advantage. Absolute and exchange rate adjusted costs are not relevant to the concept of comparative advantage.

(Study Session 5, Module 19.1, LOS 19.c)

Question #2 of 62

A government that imposes restrictions on capital flows into or out of the country is *most likely* attempting to:

A) increase domestic interest rates.

B) encourage competition in domestic industries.

C) reduce the volatility of domestic asset prices.

Explanation

Reasons commonly cited by governments for imposing capital restrictions include reducing the volatility of domestic asset prices, maintaining control of exchange rates, keeping domestic interest rates low, and protecting strategic industries from foreign ownership.

(Study Session 5, Module 19.2, LOS 19.g)

Question #3 of 62

The North American Free Trade Agreement (NAFTA) is *most accurately* described as a:

A) free trade area.

B) customs union.

C) common market.

Explanation

NAFTA is a free trade area, in which the member nations remove barriers to imports and exports among themselves. In a customs union, all members adopt common trade policies with non-members. A common market goes further, removing all barriers to movement of labor and capital among members.

(Study Session 5, Module 19.2, LOS 19.f)

Question #4 of 62

The most integrated type of trading bloc or regional trade agreement is a(n):

A) common market.

B) economic union.

C) monetary union.

Explanation

A monetary union, such as the Euro zone, is the most integrated type of trading bloc or regional trade agreement because the members adopt a common currency.

(Study Session 5, Module 19.2, LOS 19.f)

Question #5 of 62

In 20X5, Carthage's merchandise imports exceeded the value of its merchandise exports. In this case, Carthage would *most likely* have which of the following?

A) Current account surplus.

B) Balance of trade surplus.

C) Capital account surplus.

Explanation

If a country is running a current account deficit, it must have an inflow of foreign capital, creating a surplus in the capital account.

(Study Session 5, Module 19.2, LOS 19.h)

Question #6 of 62

For an analyst interested in measuring activity within an economy, the *most appropriate* measure to use is:

A) national income.

B) gross domestic product.

C) gross national product.

Explanation

Gross domestic product measures the economic output produced within a country Gross national product includes output produced by citizens working abroad and output from foreign productive assets owned by a country's citizens and does not include output produced within a country by foreign workers or from productive assets in the domestic economy owned by foreigners. GDP includes production to replace physical capital as it wears out; national income does not.

(Study Session 5, Module 19.1, LOS 19.a)

Question #7 of 62

In the Heckscher-Ohlin model, whether a country has a comparative advantage relative to another country is determined by:

A) capital productivity differences.

B) labor productivity differences.

C) amounts of labor and capital the countries possess.

Explanation

In the Heckscher-Ohlin model a country that has relatively more capital will export capital-intensive goods and import labor-intensive goods, while a country that has relatively more labor will export labor-intensive goods and import capital-intensive goods.

(Study Session 5, Module 19.1, LOS 19.d)

Question #8 of 62

Which of the following arguments in favor of trade restrictions is *least likely* to be supported by economists?

A) Infant industries should be protected.

B) National defense industries should be protected.

C) Trade with low-wage countries depresses wage rates in high-wage countries.

Explanation

Trade with low-wage countries does not in itself depress wage rates since productivity must be considered. The other arguments have some support among economists.

(Study Session 5, Module 19.2, LOS 19.e)

Question #9 of 62

In the Ricardian model of trade, the source of comparative advantage is:

A) labor productivity.

B) capital productivity.

C) the difference between labor productivity and capital productivity.

Explanation

The Ricardian model of trade only considers labor as a factor of production. Comparative advantage results from differences in labor productivity. Labor and capital inputs are both considered in the Heckscher–Ohlin model of trade.

(Study Session 5, Module 19.1, LOS 19.d)

Question #10 of 62

A country that has imports valued more than its exports is said to have a:

A) current account surplus.

B) capital account deficit.

C) current account deficit.

Explanation

A country that has imports valued more than its exports is said to have a current account (trade) deficit, while countries with more exports than imports are said to have a current account surplus.

(Study Session 5, Module 19.2, LOS 19.h)

Question #11 of 62

Who benefits the *most* from a quota?

A) Foreign consumers.

B) Foreign producers.

C) Domestic producers.

Explanation

Quotas restrict the supply of imported goods, which increases the price domestically benefiting domestic producers. Some foreign producers also benefit from the higher prices created by the quota if they receive the revenue transfer (due to higher prices received for all goods sold under the import license). However, overall the foreign producers do not sell as much of their product and have lost revenues.

(Study Session 5, Module 19.2, LOS 19.e)

Question #12 of 62

Which form of regional trading agreement is *least likely* to allow free movement of labor?

A) Customs union.

B) Economic union.

C) Common market.

Explanation

Economic unions and common markets remove all barriers to the movement of labor and capital among their members. Customs unions do not have this feature.

(Study Session 5, Module 19.2, LOS 19.f)

Question #13 of 62

The primary goals of the International Monetary Fund (IMF) include:

A) reducing global poverty.

B) resolving trade-related disputes among nations.

C) promoting exchange rate stability.

Explanation

The primary goals of the IMF are to promote international monetary cooperation, facilitate growth of international trade, promote exchange rate stability, assist in establishing a multilateral payment system, and provide resources to members with balance of payments difficulties. Reducing global poverty is a role of the World Bank. Resolving trade disputes is a role of the World Trade Organization.

(Study Session 5, Module 19.2, LOS 19.j)

Question #14 of 62

In the context of international trading blocs, the primary feature of an economic union that distinguishes it from a common market is the adoption of a common:

A) currency.

B) set of trade restrictions with non-members.

C) set of economic policies.

Explanation

An economic union is a common market that has also adopted common institutions and economic policy. Both common markets and economic unions adopt a common set of trade restrictions with non-members. Neither requires the adoption of a common currency, which is a characteristic of a monetary union.

(Study Session 5, Module 19.2, LOS 19.f)

Question #15 of 62

Other things equal, a current account deficit will tend to narrow if:

A) private savings decrease.

B) taxes decrease.

C) domestic investment decreases.

Explanation

The relation between the trade deficit (the current account), savings (both private and government) and domestic investments is stated as (X – M) = private savings + government savings – investment. A current account deficit will tend to narrow if private savings increase, government savings increase (either taxes increase or government spending decreases), or domestic investment decreases.

(Study Session 5, Module 19.2, LOS 19.i)

Question #16 of 62

In the context of foreign trade, quotas are *best* described as:

A) taxes on imported goods collected by the government.

B) government payments to firms that export goods.

C) limits on the amounts of imports a country allows over some period.

Explanation

Quotas are limits on the amounts of imports allowed into a country in a period of time. Government payments to firms that export goods are known as export subsidies. Taxes on imported goods collected by the government are known as tariffs.

(Study Session 5, Module 19.2, LOS 19.e)

Question #17 of 62

Costs of international trade are *most likely* borne by:

A) consumers who have fewer choices of goods.

B) industries competing with imported goods.

C) consumers who pay higher prices for consumer goods.

Explanation

Industries competing with imported goods may experience lower profit and employment due to international trade.

(Study Session 5, Module 19.1, LOS 19.b)

Question #18 of 62

Capital transfers and sales of non-financial assets are included in which of the balance of payments accounts?

A) Financial account.

B) Capital account.

C) Current account.

Explanation

Capital transfers and sales of non-financial assets are sub-accounts of the capital account.

(Study Session 5, Module 19.2, LOS 19.h)

Question #19 of 62

For a country that produces €100 million more income from foreign capital invested within the country than from domestic investment abroad, and produces €100 million more goods and services by foreign labor within the country than by its citizens abroad, gross national product is:

A) greater than gross domestic product.

B) equal to gross domestic product.

C) less than gross domestic product.

Explanation

GNP measures output produced by a country's citizens and capital owned by its citizens. GDP measures output produced within a country. In this example, production within the country (GDP) is greater than production by the country's citizens (GNP).

(Study Session 5, Module 19.1, LOS 19.a)

Question #20 of 62

The *most* accurate description of the relative roles played by the International Monetary Fund, World Bank, and World Trade Organization is that the only one explicitly focused on:

A) providing funding to member nations is the International Monetary Fund. ✗

B) expanding international trade is the World Trade Organization. ✗

C) reducing poverty is the World Bank. ✓

Explanation

The World Bank has the explicit mission of fighting poverty. Both the WTO and IMF work to expand international trade. Both the World Bank and IMF provide funds to member nations, the World Bank for development and the IMF when member nations experience balance of payments difficulties.

(Study Session 5, Module 19.2, LOS 19.j)

Question #21 of 62

Compared to not engaging in international trade, a country that engages in international trade is *most likely* to experience:

A) increased specialization of domestic industries. ✓

B) higher prices for consumer goods. ✗

C) lower employment in exporting industries. ✗

Explanation

International trade should result in greater specialization in domestic industries because production shifts to lines in which domestic producers have a comparative advantage.

(Study Session 5, Module 19.1, LOS 19.b)

Question #22 of 62

Regional trade agreements exist primarily to:

A) protect their members from unfair trading practices by non-members. ✗

B) lower currency volatility for their members. ✗

C) improve economic welfare for their members. ✓

Explanation

The primary reason countries join regional trade agreements is to improve economic welfare by reducing or eliminating trade restrictions.

(Study Session 5, Module 19.2, LOS 19.f)

Question #23 of 62

Country P imports goods from Country Q. In the long run, the benefits of international trade *most likely* accrue to:

A) Country P only.

B) Country Q only.

C) Both Country P and Country Q.

Explanation

The overall benefits of international trade are greater than the costs for the global economy as a whole. All countries should benefit in the long run as costs of international trade are mostly short run effects.

(Study Session 5, Module 19.1, LOS 19.b)

Question #24 of 62

In contrast to gross domestic product (GDP), gross national product (GNP) includes income earned by:

A) foreign capital invested domestically.

B) foreign labor working domestically.

C) domestic capital invested abroad.

Explanation

GNP includes goods and services produced outside the country by domestic factors of production, both labor and capital.

(Study Session 5, Module 19.1, LOS 19.a)

Question #25 of 62

The source of comparative advantage in the Heckscher-Ohlin model of trade is differences among countries in:

A) labor productivity.

B) relative scarcity of labor and capital.

C) technological advancement.

Explanation

In the Heckscher-Ohlin model of trade, the source of comparative advantage is the relative scarcity of labor and capital in each country.

(Study Session 5, Module 19.1, LOS 19.d)

Question #26 of 62

The following chart indicates the production possibilities of food and drink per day in Country A and Country B.

	Units of Output Per Day	
	Country A	**Country B**
Food	9	5
Drink	7	5

Which of the following statements is *most* accurate?

A) Since B workers can produce more of food and drink than A workers, no gains from trade are possible.

B) Mutual gains could be realized from trade if A specialized in drink production and B specialized in the food production.

C) Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production.

Explanation

Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production. The reason centers on comparative advantage. Country A must give up 7/9th unit of drink to produce one unit of food. Country B must give up 1 unit of drink to produce one unit of food. Therefore, the opportunity cost of producing food is greater for B than for A. If B produces 5 units of drink and A produces 9 units of food, total production will be greater than it would be if both countries produced both goods. By trading, both countries benefit.

(Study Session 5, Module 19.1, LOS 19.c)

Question #27 of 62

Which of the following lists of trading blocs is *most* accurately ordered by degree of economic integration, from least to most integrated?

A) Free trade area, common market, customs union.

B) Customs union, economic union, monetary union.

C) Free trade area, economic union, common market.

Explanation

The order by degree of economic integration (from least to most integrated) is as follows: free trade areas, customs union, common market, economic union, and monetary union.

(Study Session 5, Module 19.2, LOS 19.f)

Question #28 of 62

The table below outlines the possible output per unit of labor input of producing beer and cheese for Germany and Holland.

Germany		Holland	
Cheese	Beer	Cheese	Beer
5	10	4	6

Which of the following statements is *most* accurate?

A) Germany would not gain from trade, because it has an absolute advantage in the production of both goods.

B) Both countries would gain if Germany traded beer for Holland's cheese.

C) Both countries would gain if Germany traded cheese for Holland's beer.

Explanation

Germany has an absolute advantage in both beer and cheese because it can produce more of both per unit of labor input than Holland. The opportunity cost of producing beer is 5/10 = 0.5 in Germany and 4/6 = 0.67 in Holland. The opportunity cost of producing cheese is 10/5 = 2 in Germany and 6/4 = 1.5 in Holland. Holland has a comparative advantage in producing cheese and Germany has a comparative advantage in producing beer. Both countries can gain if Germany trades beer for Holland's cheese.

(Study Session 5, Module 19.1, LOS 19.c)

Question #29 of 62

The international organization whose primary role is settling disputes among trading nations is the:

A) International Monetary Fund.

B) World Bank.

C) World Trade Organization.

Explanation

The role of the World Trade Organization is to deal with rules of global trade and settle trade-related disputes among nations.

(Study Session 5, Module 19.2, LOS 19.j)

Question #30 of 62

The primary benefits derived from tariffs usually accrue to:

A) domestic suppliers of goods protected by tariffs.

B) domestic producers of export goods.

C) foreign producers of goods protected by tariffs.

Explanation

Tariffs raise domestic prices, benefiting domestic suppliers.

(Study Session 5, Module 19.2, LOS 19.e)

Question #31 of 62

Promoting international monetary cooperation, promoting exchange stability, and assisting members experiencing balance of payments difficulties are the goals of the:

A) World Bank.

B) World Trade Organization.

C) International Monetary Fund.

Explanation

The IMF's main goals are promoting international monetary cooperation; facilitating the expansion and balanced growth of international trade; promoting exchange stability; assisting in the establishment of a multilateral system of payments; and making resources available (with adequate safeguards) to members.

(Study Session 5, Module 19.2, LOS 19.j)

Question #32 of 62

Ensuring that international trade flows smoothly and freely, settling trade disputes, and establishing agreements between trading partners *most accurately* describe the activities of the:

A) World Trade Organization.

B) World Bank.

C) International Monetary Fund.

Explanation

The World Trade Organization (WTO) deals with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably, and freely as possible.

(Study Session 5, Module 19.2, LOS 19.j)

Question #33 of 62

A government that wishes to reduce the volatility of domestic asset prices and protect domestic industries is *most likely* to:

A) impose capital restrictions.

B) participate in regional trading agreements.

C) adopt voluntary export restraints.

Explanation

Objectives commonly cited for imposing capital restrictions include reducing the volatility of domestic asset prices, protecting domestic industries, maintaining fixed exchange rates, and keeping domestic interest rates low.

(Study Session 5, Module 19.2, LOS 19.g)

Question #34 of 62

Sales and purchases of non-produced, non-financial assets are included in which of a country's trade accounts?

A) Capital account.

B) Financial account.

C) Current account.

Explanation

The capital account consists of sales and purchases of non-produced, non-financial assets plus capital transfers.

(Study Session 5, Module 19.2, LOS 19.h)

Question #35 of 62

Who benefits *least* from tariffs?

A) Domestic producers.

B) Domestic consumers.

C) Foreign consumers.

Explanation

A tax imposed on imports is called a tariff, which benefits domestic producers and domestic governments. Domestic consumers lose through higher prices, less choice of products, and lower quality products.

(Study Session 5, Module 19.2, LOS 19.e)

Question #36 of 62

David Forsythe and Linda Novak are discussing the advantages and disadvantages of import restrictions. They state the following:

> Forsythe: One of the groups that benefits from import restrictions is often the government that imposes them.
>
> Novak: Import restrictions impose costs on specific groups, such as the country's import industries, but these costs are more than offset by the benefits to other groups and to the economy as a whole.

With respect to these statements:

A) both are correct.

B) both are incorrect.

C) only one is correct.

Explanation

Forsythe is correct. A primary reason why trade restrictions remain widespread is the revenue that governments receive from tariffs. Novak is incorrect. Trade restrictions benefit specific groups, such as workers in the protected industries, but those benefits are most often less than the costs imposed on consumers and other industries as a whole.

(Study Session 5, Module 19.2, LOS 19.e)

Question #37 of 62

If a country can produce a good at a lower opportunity cost relative to another country, it is said to have a(n):

A) autarkian advantage.

B) comparative advantage.

C) absolute advantage.

Explanation

A country is said to have a comparative advantage in the production of a good if its opportunity cost, in terms of other goods that could be produced instead, is lower than that of another country.

(Study Session 5, Module 19.1, LOS 19.c)

Question #38 of 62

Holding other factors constant, a country can reduce its trade deficit by increasing its:

A) government budget deficit.

B) domestic capital investment.

C) private saving.

Explanation

Other things equal, increasing savings would decrease a current account deficit, while increasing a government budget deficit or domestic investment would increase a current account deficit.

(Study Session 5, Module 19.2, LOS 19.i)

Question #39 of 62

The *least likely* result of import quotas and voluntary export restraints is:

A) a shift in production toward higher-cost suppliers.

B) a decrease in the quantity of imports of the product.

C) increased revenue for the government.

Explanation

Import quotas and voluntary export restraints, unlike tariffs, do not necessarily generate tax revenue. The other choices describe effects that result from tariffs, quotas, and VERs.

(Study Session 5, Module 19.2, LOS 19.e)

Question #40 of 62

Prior to the beginning of summer, the government of Japan places a 150 percent tariff on imported chain saws. Assume for this example that this tariff has a significant impact on the supply of chain saws. The government's action:

A) is more harmful than if the government had limited the amount of chain saws imported.

B) will protect the jobs and high wages of Japanese chain saw industry workers.

C) benefits the Japanese government and domestic producers.

Explanation

The Japanese government's action is an example of a *tariff*. A tariff is a tax imposed on imports and benefits the Japanese government because it collects the tariff. Domestic producers benefit because the reduction in the supply of imported goods means a higher domestic price.

The other choices are incorrect. A tariff is considered *less* harmful than a quota (an import quantity limitation) because under a quota, the domestic government does *not* receive any funds as it would under a tariff (the foreign producers receive the revenue transfer). In the long run, trade restrictions do not protect the net number of jobs in the country. The number of jobs protected by import restrictions will be offset by jobs lost in the import/export industry. Import/export firms will be unable to sell the overpriced domestic products abroad or import and sell the lower priced restricted foreign-made product.

(Study Session 5, Module 19.2, LOS 19.e)

Question #41 of 62

In what way does a tariff differ from a quota? A tariff is:

A) not significantly different from a quota; tariffs are imposed by world organizations, whereas quotas are imposed by individual countries.

B) a tax imposed on imports, whereas a quota is a limit on the number of units of a good that can be imported.

C) a tax imposed by a foreign government, whereas a quota is a limit on the total amount of trade allowed.

Explanation

The difference between a tariff and a quota is that a *tariff* is a tax imposed on imported goods, while a *quota* is an import quantity limitation. Also, a tariff will generate tax revenue, but a quota does not.

(Study Session 5, Module 19.2, LOS 19.e)

Question #42 of 62

Which of the following statements about the costs and benefits of international trade is *most* accurate?

A) Increased international trade benefits all groups in the trading countries.

B) The costs of trade primarily affect those in domestic industries that compete with imports.

C) The costs of trade are greater than the benefits with regard to domestic employment.

Explanation

The benefits of trade are greater than the costs for the overall economy, but those in domestic industries competing with imports may suffer costs in the form of reduced profits or employment.

(Study Session 5, Module 19.1, LOS 19.b)

Question #43 of 62

Which type of advantage determines the pattern of trade in the world?

A) Comparative advantage.

B) Advantages due to tariffs and quotas.

C) Absolute advantage.

Explanation

Comparative advantage is the ability to produce a good at a lower opportunity cost than others can produce it. According to the law of comparative advantage, trading partners are *both* better off if they specialize in the production of goods for which they are the low-opportunity cost producer and trade for goods for which they are the high-opportunity cost producer.

(Study Session 5, Module 19.1, LOS 19.c)

Question #44 of 62

Two countries trade freely with each other and have agreed to specific tariffs on imports from other countries. The workers in either country may freely cross the common border to work in the other country. The two countries have agreed to common economic policies, but they use separate currencies. This type of cooperation is *best* described as a(n):

A) monetary union.

B) customs union.

C) economic union.

Explanation

The two countries are a part of an economic union. In an economic union, there is (1) free trade among members, (2) common restrictions (tariffs) on imports from non-members, (3) free movement of production factors (labor), and (4) common economic institutions and coordination of economic policies. While a customs union has common tariffs on imports from non-union countries and free trade, it does not allow workers to cross the borders freely and does not have common economic institutions. A monetary union requires all of the listed items and a common currency.

(Study Session 5, Module 19.2, LOS 19.f)

Question #45 of 62

An anti-dumping restriction on trade:

A) prohibits foreign firms from selling products below cost to gain market share.

B) keeps some highly sensitive products in the country.

C) protects infant industries.

Explanation

Firms dump their goods at a price lower than cost in order to drive out the competition. Once this is complete, they will be able to raise prices to much higher levels in order to gain abnormal profits. Of course, once prices are increased, new competitors may arise.

(Study Session 5, Module 19.2, LOS 19.e)

Question #46 of 62

The law of comparative advantage explains why a nation will benefit from trade when it:

A) exports goods for which it is a low-cost producer, while importing those for which it is a high-cost producer.

B) exports more than it imports.

C) exports goods for which it is a high-cost producer, while importing those for which it is a low-cost producer.

Explanation

Comparative advantage is the ability to produce a good at a lower opportunity cost than others can produce it. When trading partners specialize in producing products for which they have a comparative advantage; costs are minimized, output is greater, and both trading partners benefit.

(Study Session 5, Module 19.1, LOS 19.c)

Question #47 of 62

Suppose the world price of Mercury tennis shoes is $60, but they sell in the U.S. for $75 due to a $15 import tariff. Who will *most likely* be negatively affected by the tariff?

A) U.S. consumers.

B) Producers.

C) Foreign consumers.

Explanation

Tariffs benefit domestic producers of products because the level of imports will be reduced due to an effective increase in the price of the goods. Consumers in the country lose due to higher prices.

(Study Session 5, Module 19.2, LOS 19.e)

Question #48 of 62

Which of the following groups in the country of Minidonia would *least likely* be helped by the imposition of tariffs on Minidonian imports of transportation equipment?

A) Trucking companies.

B) Automotive manufacturers.

C) Minidonia's government.

Explanation

Tariffs on transportation equipment benefit the government in the form of tariff revenue, and benefit domestic producers and industry workers in the form of higher prices for transportation equipment. The users of transportation equipment, such as trucking companies, suffer from higher costs due to the higher prices of transportation equipment.

(Study Session 5, Module 19.2, LOS 19.e)

Question #49 of 62

According to the law of comparative advantage:

A) Mexico is considered to have a comparative advantage in plastics if Mexico can produce plastic using fewer resources than the U.S.

B) a nation will benefit from trade when it imports goods for which it is the high cost producer and exports goods for which it is the low-cost producer.

C) if a foreign government subsidizes the textile industry, the domestic government should impose a tariff.

Explanation

This statement is the law of comparative advantage.

The other choices are incorrect. The law of comparative advantage supports international trade. According to the law of comparative advantage, both trading partners are better off if they specialize in the production of goods for which they are the low-opportunity cost producer and trade for those goods for which they are the high-opportunity cost producer. Mexico is considered to have *an absolute* advantage in plastics if Mexico can produce plastic using fewer resources than the U.S.

(Study Session 5, Module 19.1, LOS 19.c)

Question #50 of 62

A country has a comparative advantage over another when:

A) a nation has the ability to produce a good with a lower opportunity cost than another nation.

B) it can produce a product with the fewest resources.

C) a nation can produce more output with a given amount of input than another nation.

Explanation

A nation will have a comparative advantage in the production of good A when the number of units of B, given up to produce one unit of A, is lower than that for any other country.

(Study Session 5, Module 19.1, LOS 19.c)

Question #51 of 62

Which of the items below is NOT a valid reason why nations adopt trade restrictions? To:

A) protect industries that are highly sensitive to national security.

B) prohibit foreign firms from increasing market share by selling products below cost.

C) protect industries in which they have a comparative advantage.

Explanation

If a particular country enjoys a comparative advantage in a particular industry, no protection is needed.

(Study Session 5, Module 19.2, LOS 19.e)

Question #52 of 62

In a country that has a current account surplus, it is *most likely* that:

A) private domestic savings are greater than the budget deficit.

B) domestic savings are greater than domestic investment.

C) domestic investment is greater than government savings.

Explanation

The relationship between saving, investment, and the trade deficit can be expressed as:

(exports – imports) = private savings + government savings – investment

A country will have a current account surplus (exports > imports) if the sum of domestic private savings and government savings is greater than domestic investment, or a current account deficit (imports > exports) if the sum of domestic private savings and government savings is less than domestic investment.

(Study Session 5, Module 19.2, LOS 19.i)

Question #53 of 62

The table below outlines the possible tradeoffs of producing units of cloth and corn, using one hour of labor input, for Country A and Country B.

Country A		Country B	
Units of Cloth	**Units of Corn**	**Units of Cloth**	**Units of Corn**
14	4	16	8

Country A has a comparative advantage in producing:

A) cloth.

B) corn.

C) neither cloth nor corn.

Explanation

To produce a unit of cloth, Country A must give up 4/14 = 0.29 units of corn, while Country B must give up 8/16 = 0.50 units of corn. Therefore Country A has a comparative advantage (i.e., a lower opportunity cost) in producing cloth.

To produce a unit of corn, Country A must give up 14/4 = 3.5 units of cloth, while Country B must give up 16/8 = 2.0 units of cloth. Therefore Country B has a comparative advantage in producing corn.

Note that this question gives output per unit of labor. In other questions you may see labor hours per unit of output. For this question that would be 1/14 units of labor per unit of cloth and 1/4 unit of labor per unit of corn for Country A, and 1/16 unit of labor per unit of corn and 1/8 unit of labor per unit of cloth for Country B. No matter how the data are presented, just focus on the trade-off, what each country must give up of one good to produce one unit of the other good.

(Study Session 5, Module 19.1, LOS 19.c)

Question #54 of 62

Government-owned assets abroad and foreign-owned assets in the country are included in which of the balance of payments accounts?

A) Current account.

B) Capital account.

C) Financial account.

Explanation

Government-owned assets abroad and foreign-owned assets in the country are sub-accounts of the financial account.

(Study Session 5, Module 19.2, LOS 19.h)

Question #55 of 62

Which of the following is *least likely* a common objective of governmental capital restrictions?

A) Keep domestic interest rates high.

B) Reduce the volatility of domestic asset prices.

C) Maintain fixed exchange rates.

Explanation

A common objective of capital restrictions is to keep domestic interest rates low (not high), by eliminating competition by other countries for investor funds. The other two choices are common objectives of capital restrictions.

(Study Session 5, Module 19.2, LOS 19.g)

Question #56 of 62

The income from a country's citizens working abroad is included in:

A) both gross domestic product and gross national product.

B) gross national product, but not gross domestic product.

C) gross domestic product, but not gross national product.

Explanation

Gross domestic product includes the total value of goods and services produced within a country's borders. The income of a country's citizens working abroad is included in its GNP but not in its GDP.

(Study Session 5, Module 19.1, LOS 19.a)

Question #57 of 62

The balance of payments accounts consist of:

A) current account, capital account, and currency account.

B) current account, capital account, and financial account.

C) capital account, financial account, and non-financial account.

Explanation

According to the U.S. Federal Reserve, "The BOP [balance of payments] includes the current account, which mainly measures the flows of goods and services; the capital account, which consists of capital transfers and the acquisition and disposal of non- produced, non-financial assets; and the financial account, which records investment flows."

(Study Session 5, Module 19.2, LOS 19.h)

Question #58 of 62

The following chart indicates the production possibilities of food and drink per day in Country A and Country B.

	Units of Output Per Day	
	Country A	**Country B**
Food	4	8
Drink	6	7

Which of the following statements about the chart is *most* accurate?

A) Mutual gains could be realized from trade if A specialized in food production and B specialized in drink production.

B) Mutual gains could be realized from trade if A specialized in drink production and B specialized in the food production.

C) Since B workers can produce more of food and drink than A workers, no gains from trade are possible.

Explanation

Mutual gains could be realized from trade if A specialized in drink production and B specialized in food production. The reason centers on comparative advantage. Country A must give up 1.5 units of drink to produce one unit of food. Country B must give up 0.875 units of drink to produce one unit of food. Therefore, the opportunity cost of producing food is greater for A than for B. If B produces 8 units of food and A produces 6 units of drink, total production will be greater than it would be if both countries produced both goods. By trading, both countries benefit.

(Study Session 5, Module 19.1, LOS 19.c)

Question #59 of 62

Merchandise and services, income receipts, and unilateral transfers are included in which of the balance of payments accounts?

A) Capital account.

B) Financial account.

C) Current account.

Explanation

Merchandise and services, income receipts, and unilateral transfers are sub-accounts of the current account.

(Study Session 5, Module 19.2, LOS 19.h)

Question #60 of 62

The form of regional trading agreement (RTA) *least likely* to have the unintended negative effect of reducing a member country's low-cost imports from a non-member country is a:

A) free trade area.

B) customs union.

C) common market.

Explanation

A free trade area removes barriers to trade among its members but does not require any of its members to change their trade policies with non-members. A common market and a customs union both impose uniformity on trade rules with non-member nations, which could restrict a member's low-cost imports from a nation that is not a member.

(Study Session 5, Module 19.2, LOS 19.f)

Question #61 of 62

Suppose labor in Venezuela is less productive than labor in the United States in all areas of production. Which of the following statements about trading between Venezuela and the U.S. is *most* accurate?

A) Venezuela can benefit from trade but the U.S. cannot.

B) Venezuela will not have a comparative advantage in any good.

C) Both nations can benefit from trade.

Explanation

Although one country may have an absolute advantage in all areas, trade is based on differences in opportunity costs, or comparative advantage. Any country will always have a comparative advantage in the production of some goods; thus, all countries can benefit from trade.

(Study Session 5, Module 19.1, LOS 19.c)

Question #62 of 62

In the balance of payments accounts, goods and financial assets that migrants bring to a country are included in the:

A) financial account.

B) capital account.

C) current account.

Explanation

The capital account includes goods and financial assets that migrants bring when they come to a country or take with them when they leave.

(Study Session 5, Module 19.2, LOS 19.h)