Chapter 2

*Student: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_*

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| 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?      |

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| 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?      |

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

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| 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."      |

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| 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?      |

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| 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 |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 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. |

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| --- | --- |
| D.  | one country's gain from trade was associated with a loss for the other country. |

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| 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. |

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| 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. |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 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. |

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| --- | --- |
| D.  | all of the above. |

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| 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 |

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| 12. | Two important assumptions contained in David Hume's price specie-flow adjustment mechanism are that

|  |  |
| --- | --- |
| A.  | countries are at full employment and the demands for traded goods are "inelastic." |

|  |  |
| --- | --- |
| B.  | countries are at full employment and the price level of a country moves in inverse proportion to movements in the country's money supply. |

|  |  |
| --- | --- |
| C.  | a country with a balance-of-payments deficit will experience a gold outflow and countries are at a level of employment that is below full employment. |

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| --- | --- |
| D.  | the demands for traded goods are "elastic" and countries are at full employment. |

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| 13. | 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 |

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| 14. | 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. |

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| D.  | works equally effectively whether demands for traded goods are "price-elastic" or "price-inelastic." |

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| 15. | 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. |

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| 16. | 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. |

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| --- | --- |
| B.  | laissez-faire. |

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| --- | --- |
| C.  | the labor theory of value. |

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| D.  | Mercantilism. |

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| 17. | A Mercantilist policymaker would be in favor of which of the following policies or events pertaining to his/her country?

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| --- | --- |
| A.  | a decrease in the size of the population. |

|  |  |
| --- | --- |
| B.  | a minimum wage bill to protect the standard of living of workers. |

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| --- | --- |
| C.  | a prohibition on the export of manufactured goods. |

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| 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. |

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| 18. | 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?

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| 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. |

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| D.  | Price changes in the surplus country cause that country's exports to decrease. |

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| 19. | 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 |

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| 20. | The "paradox of Mercantilism" reflected that fact that

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| A.  | trade surpluses were fostered by protective tariffs. |

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| --- | --- |
| B.  | rich countries were comprised of large numbers of poor people. |

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| C.  | gold inflows led to higher prices and reduced exports. |

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| D.  | gold could not be hoarded and provide money for the economy at the same time. |

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| 21. | 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:  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 |

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| 22. | With MS = 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.  | MSY = PV |

|  |  |
| --- | --- |
| B.  | MSP = VY |

|  |  |
| --- | --- |
| C.  | MS = PY - V |

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| --- | --- |
| D.  | MSV = PY |

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| 23. | 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 |

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| 24. | In the price-specie-flow adjustment mechanism, a country with a balance-of-trade surplus experiences

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| --- | --- |
| 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. |

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| 25. | 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 |

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Chapter 2 Key

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| 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?   |

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| *Appleyard - Chapter 02 #1* |

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| 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?   |

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| *Appleyard - Chapter 02 #2* |

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

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| *Appleyard - Chapter 02 #3* |

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| 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."   |

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| *Appleyard - Chapter 02 #4* |

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| 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?   |

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| *Appleyard - Chapter 02 #5* |

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| 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 |

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| *Appleyard - Chapter 02 #6* |

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| 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. |

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| *Appleyard - Chapter 02 #7* |

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| 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. |

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| *Appleyard - Chapter 02 #8* |

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| 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. |

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| *Appleyard - Chapter 02 #9* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 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. |

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| *Appleyard - Chapter 02 #10* |

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| 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 |

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| *Appleyard - Chapter 02 #11* |

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 12. | Two important assumptions contained in David Hume's price specie-flow adjustment mechanism are that

|  |  |
| --- | --- |
| A.  | countries are at full employment and the demands for traded goods are "inelastic." |

|  |  |
| --- | --- |
| B.  | countries are at full employment and the price level of a country moves in inverse proportion to movements in the country's money supply. |

|  |  |
| --- | --- |
| C.  | a country with a balance-of-payments deficit will experience a gold outflow and countries are at a level of employment that is below full employment. |

|  |  |
| --- | --- |
| **D.**  | the demands for traded goods are "elastic" and countries are at full employment. |

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| *Appleyard - Chapter 02 #12* |

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| 13. | 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 |

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| *Appleyard - Chapter 02 #13* |

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| 14. | 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." |

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| *Appleyard - Chapter 02 #14* |

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 15. | 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. |

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| *Appleyard - Chapter 02 #15* |

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| 16. | 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. |

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| --- | --- |
| D.  | Mercantilism. |

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| *Appleyard - Chapter 02 #16* |

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| 17. | 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. |

|  |  |
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| **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. |

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| *Appleyard - Chapter 02 #17* |

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| 18. | 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. |

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| *Appleyard - Chapter 02 #18* |

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| 19. | 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 |

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| *Appleyard - Chapter 02 #19* |

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| 20. | 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. |

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| *Appleyard - Chapter 02 #20* |

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| 21. | 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:  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 |

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| *Appleyard - Chapter 02 #21* |

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| 22. | With MS = 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.  | MSY = PV |

|  |  |
| --- | --- |
| B.  | MSP = VY |

|  |  |
| --- | --- |
| C.  | MS = PY - V |

|  |  |
| --- | --- |
| **D.**  | MSV = PY |

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| *Appleyard - Chapter 02 #22* |

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| 23. | 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 |

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| *Appleyard - Chapter 02 #23* |

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| 24. | 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. |

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| *Appleyard - Chapter 02 #24* |

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| 25. | 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 |

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| *Appleyard - Chapter 02 #25* |

Chapter 2 Summary

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| *Category* | *# of Questions* |
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