Chapter 2

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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. |  |  |  | | --- | --- | | 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. |  |  |  | | --- | --- | | 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. |  |  |  | | --- | --- | | 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. |  |  |  | | --- | --- | | 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. |  |  |  | | --- | --- | | B. | laissez-faire. |  |  |  | | --- | --- | | C. | the labor theory of value. |  |  |  | | --- | --- | | 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?      |  |  | | --- | --- | | 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. | |

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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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| 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      |  |  | | --- | --- | | 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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| 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 |  |  |  | | --- | --- | | 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      |  |  | | --- | --- | | 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 | |

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* |

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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. |  |  |  | | --- | --- | | **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. |  |  |  | | --- | --- | | 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. |  |  |  | | --- | --- | | **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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| 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 |  |  |  | | --- | --- | | **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      |  |  | | --- | --- | | 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 Summary

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