Answer Key – Exam #1

**Multiple Choice**

1. D
2. C
3. C
4. D
5. A
6. B
7. A
8. A
9. C
10. D

**Short Answer**

1. Under a situation of identical tastes and production abilities, we could not turn to standard trade theory (Com Adv, Abs Adv, H-O) for why countries trade. However, it could be that these goods are subject to intra-industry or intra-firm trade, as well as the product life cycle.
2. Potential trade war, domestic resources are being devoted to production of goods that do not have the comparative advantage, etc.
3. Graph that shows a world price less than the domestic price. Also should label welfare so it can be shown that free trade increases CS, decreases PS, and the increase in the CS>decreases PS.

**Problems**

1. 
   a. (3 points) The K/L ratio to make steel is ¼, the K/L to make bread is 1/8. 
   b. (3 points) Since the US is capital abundant and steel is K-intensive, according to the H-O theory, the US will export steel and Canada will export bread. 
   c. (3 points) The changes in the returns to K are different in each country. Owners of capital in the US benefit from trade, while owners of labor are hurt. In Canada, the opposite is true. 
   d. (3 points) It would have to realize growth in labor more than growth in capital. 
2. 
   a. (2 points) Consumption = 20, Production = 11.67
   b. (3 points) CS= 400, PS = 204.17
   c. (3 points) Prices rise from 40 to 44. Q falls to 18, domestic production rises to 13
   d. (3 points) CS falls to 324, or by 76. PS rises to 253.5, or by 49.33
   e. (3 points) Tariff revenue is 5 x $4 = $20