International Economics 11th Edition Salvatore Solutions Manual

CHAPTER 1
*(Core Chapter)

INTRODUCTION

OUTLINE

1.1 The Globalization of the World Economy
- 1.1A We Live in a Global Economy
- Case Study 1-1: The Dell PCs, iPhones and iPads Sold in the U.S. Are Anything But American!
- Case Study 1-2: What Is an "American" Car?
- 1.1B The Globalization Challenge
- Case Study 1-3: Is India's Globalization Harming the United States?

1.2 International Trade and The Nation's Standard of Living
- Case Study 1-4: Rising Importance of International Trade to the United States

1.3 The International Flow of Goods, Services, Labor and Capital
- 1.3A The International Flow of Goods and Services: The Gravity Model
- 1.3B The International Flow of Labor and Capital
- Case Study 1-4: Major Net Exporters and Importers of Capital

1.4 International Economic Theories and Policies
- 1.4A Purpose of International Economic Theories and Policies
- 1.4B The Subject Matter of International Economics

1.5 Current International Economic Problems

1.6 Organization and Methodology of the Book
- 1.6A Organization of the Text
- 1.6B Methodology of the Text

Appendix:
- A1.1 Basic International Trade Data
- A1.2 Sources of Additional International Data and Information

Key Terms

Globalization
Anti-globalization movement
Interdependence
Gravity model
International trade theory
International trade policy
New protectionism
Foreign exchange markets
Balance of payments
Adjustment in the balance of payments
Microeconomics
Macroeconomics
Open economy macroeconomics
International finance

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Lecture Guide

1. As the first chapter of the book, the general aim here is to define the field of study of international economics and its importance in today's interdependent world.

   The material in this chapter can be covered in two classes. I would utilize one class to cover Sections 1 to 3 and the second class to cover Sections 4 to 6. I would spend most of the second class on Section 3 on the major current international economic problems facing the United States and the world today and to show how international economics can suggest ways to solve them. This should greatly enhance students' motivation.

Answer to Problems

1. a) International economic problems reported in our daily newspapers are likely to include:

   - Slow growth and high unemployment in advanced economies;
   - trade controversies between the United States, Europe, Japan, and China;
   - excessive volatility of exchange rates;
   - huge and unsustainable trade deficits of the United States;
   - structural unemployment in advanced economies and insufficient restructuring in transition economies;
   - deep poverty in many developing nations;
   - resource scarcity, environmental degradation and climate changes

   b) The effect of each of the above problems on the U.S. economy are:

   - stagnant standard of living and economic suffering;
   - increased protectionism and the danger of trade wars;
   - discourages foreign trade and investments;
   - can result in trade protectionism and/or deep dollar depreciation;
   - reduces advanced countries' imports of goods and services from the rest of the world;
   - can lead to political instability abroad that would adversely affect the U.S.;
   - endangers future standard of living in the U.S. and abroad.

   c) The effect of each of the current international economic problems can affect each of us, as follows:

   - Can lose job and suffer financial losses;
   - pay higher prices for imported products;
   - great fluctuations in the price of imported products and cost of foreign travel;

- can lead you to support demands for trade protection;
- slower growth of wages and incomes;
- can lead to higher taxes to help poor countries;
- can result in higher taxes and price of fuel and other products.

2. a) Five industrial nations not mentioned are: France, Italy, Spain, Sweden, and Austria.

   b) See Table 1A.

   Note that, generally, smaller nations have higher percentages of imports and exports to GDP. The exception is Spain, which though economically smaller than Italy, has a smaller percentage of imports and exports to GDP than Italy.

Table 1A

Economic Interdependence as Measured by Imports and Exports as a Percentage of GDP, 2010

Nation	Imports as a percent of GDP	Exports as a percent of GDP
France	27.7	25.4
Italy	28.5	26.7
Spain	28.4	26.2
Sweden	44.1	49.9
Austria	50.5	55.3

Source: *International Financial Statistics* (Washington, D.C., IMF, November 2011).

3. a) Five developing nations not mentioned in the text are: Brazil, Pakistan, Colombia, Morocco, and Tunisia.

   b) See Table 1B.

   Note that, once again, the smaller the nation, the greater is its economic interdependence.

Table 1B

Economic Interdependence as Measured by Imports
and Exports as a Percentage of GDP, 2010

Nation	Imports as a percent of GDP	Exports as a percent of GDP
Brazil	12.1	11.2
Pakistan	19.0	12.9
Peru	22.8	25.78
Morocco	39.5	28.6
Tunisia	47.9	45.0

Source: *IFS* (Washington, D.C., IMF, November 2011).

4. Trade between the United States and Brazil is much larger than trade between the United States and Argentina. Since Brazil is larger and closer than Argentina, this trade does follow the predictions of the gravity model.

5. a) Mankiw's *Economics* (6th., 2011) includes the following microeconomics topics:

- The market forces of demand and supply;
- elasticity and its application;
- the theory of consumer choice;
- consumers, producers, and the efficiency of markets;
- the costs of production;
- firms in competitive markets;
- monopoly;
- oligopoly;
- monopolistic competition;
- markets for the factors of production;
- the demand for resources;

b) Just as the microeconomics parts of your principles text deal with individual consumers and firms, and with the price of individual commodities and factors of production, so do Parts One and Two of this text deal with production and consumption of individual nations with nations with and without trade, and with the relative price of individual commodities and factors of production.

c) Mankiw's Economics (6th., 2011) includes the following microeconomics topics: measuring a nation's income and the cost of living;

- production and growth;
- savings investment and the financial system;
- unemployment and its natural rate;
- the monetary system, growth and inflation;
- money growth and inflation;
- open-economy macroeconomics: basic concepts;
- a macroeconomic theory of the open economy;
- aggregate demand and aggregate supply;
- the influence of monetary and fiscal policy on aggregate demand;
- the short-run trade off between inflation and unemployment
- five debates over macroeconomic policy.

d) Just as the macroeconomics parts of your principles text deal with the aggregate level of savings, consumption, investment, and national income, the general price level, and monetary and fiscal policies, so do Parts Three and Four of this text deal with the aggregate amount of imports, exports, the total international flow of resources, and the policies to affect these broad aggregates.

6. a) Consumer demand theory predicts than when the price of a commodity rises (cet. par.), the quantity demanded of the commodity declines.

When the price of imports rises to domestic consumers, the quantity demanded of imports can be expected to decline (if everything else remains constant).

7. a) A government can reduce a budget deficit by reducing government expenditures and/or increasing taxes.

b) A nation can reduce or eliminate a balance of payments deficit by taxing imports and/or subsidizing exports, by borrowing more abroad or lending less to other nations, as well as by reducing the level of its national income.

8. a) Nations usually impose restrictions on the free international flow of goods, services, and factors. Differences in language, customs, and laws also hamper these international flows. In addition, international flows may involve receipts and payments in different currencies, which may change in value in relation to one another through time. This is to be contrasted with the interregional flow of goods, services, and factors, which face no such restrictions as tariffs and are conducted in terms of the same currency, usually in the same language, and under basically the same set of customs and laws.

b) Both international and interregional economic relations involve the overcoming of space or distance. Indeed, they both arise from the problems created by distance. This distinguishes them from the rest of economics, which abstracts from space and treats the economy as a single point in space, in which production, exchange, and consumption take place.

9. We can deduce that nations benefit from voluntarily engaging in international trade because if they did not gain or if they lost they could avoid those losses by simply refusing to trade. Disagreement usually arises regarding the relative distribution of the gains from specialization in production and trade, but this does not mean that each nation does not gain from trade.

10. International trade results in lower prices for consumers but harms domestic producers of products, which compete with imports. Often those domestic producers that stand to lose a great deal from imports band together to pressure the government to restrict imports. Since consumers are many and unorganized and each individually stands to lose only very little from the import restrictions, governments often give in to the demands of producers and impose some import restrictions. These topics are discussed in detail in Chapter 8.

11. A nation can subsidize exports of the commodity to other nations until it drives the competing nation's industry out of business, after which it can raise its price and benefit from its newly acquired monopoly power.

Some economists and politicians in the United States have accused Japan of doing just that (i.e., of engaging in strategic trade and industrial policy at the expense of U.S. industries), but this is a very complex and controversial aspect of trade policy and will be examined in detail in Chapter 9.

12. a) When the value of the U.S. dollar falls in relation to the currencies of other nations, imports become more expensive for Americans and so they would purchase a smaller quantity of imports.

b) When the value of the U.S. dollar falls in relation to the currencies of other nations, U.S. exports become chapter for foreigners and so they would purchase a greater quantity of U.S. exports.

Multiple-Choice Questions

1. Which of the following products are not produced at all in the United States?

*a. Coffee, tea, cocoa
b. steel, copper, aluminum
c. petroleum, coal, natural gas
d. typewriters, computers, airplanes

2. International trade is most important to the standard of living of:

a. the United States
*b. Switzerland
c. Germany
d. England

3. Over time, the economic interdependence of nations has:

*a. grown
b. diminished
c. remained unchanged
d. cannot say

4. A rough measure of the degree of economic interdependence of a nation is given by:

a. the size of the nations' population
b. the percentage of its population to its GDP
*c. the percentage of a nation's imports and exports to its GDP
d. all of the above

5. Economic interdependence is greater for:

*a. small nations
b. large nations
c. developed nations
d. developing nations

6. The gravity model of international trade predicts that trade between two nations is larger

a. the larger the two nations
b. the closer the nations
c. the more open are the two nations
*d. all of the above

7. International economics deals with:

a. the flow of goods, services, and payments among nations
b. policies directed at regulating the flow of goods, services, and payments
c. the effects of policies on the welfare of the nation
*d. all of the above

8. International trade theory refers to:

*a. the microeconomic aspects of international trade
b. the macroeconomic aspects of international trade
c. open economy macroeconomics or international finance
d. all of the above

9. Which of the following is not the subject matter of international finance?

a. foreign exchange markets
b. the balance of payments
*c. the basis and the gains from trade
d. policies to adjust balance of payments disequilibria

10. Economic theory:

a. seeks to explain economic events
b. seeks to predict economic events
c. abstracts from the many detail that surrounds an economic event
*d. all of the above

11. Which of the following is not an assumption generally made in the study of international economics?

a. two nations
b. two commodities
*c. perfect international mobility of factors
d. two factors of production

12. In the study of international economics:

a. international trade policies are examined before the bases for trade
b. adjustment policies are discussed before the balance of payments
c. the case of many nations is discussed before the two-nations case
*d. none of the above

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13. International trade is similar to interregional trade in that both must overcome:

*a. distance and space
b. trade restrictions
c. differences in currencies
d. differences in monetary systems

14. The opening or expansion of international trade usually affects all members of society:

a. positively
b. negatively
*c. most positively but some negatively
d. most negatively but some positively

15. An increase in the dollar price of a foreign currency usually:

a. benefit U.S. importers
*b. benefits U.S. exporters
c. benefit both U.S. importers and U.S. exporters
d. harms both U.S. importers and U.S. exporters

16. Which of the following statements with regard to international economics is true?

a. It is a relatively new field
*b. it is a relatively old field
c. most of its contributors were not economists
d. none of the above

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