

# Chapter 5

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

1. The success of the rose industry in Ecuador is a good example of the economic benefits of what?
  - A. Free trade
  - B. Restrictive government regulations
  - C. New tax rules
  - D. Technological advancements
  - E. Firm rivalry
2. Propagated in the 16<sup>th</sup> and 17<sup>th</sup> centuries, \_\_\_\_\_ advocated that countries should simultaneously encourage exports and discourage imports.
  - A. ethnocentrism
  - B. capitalism
  - C. collectivism
  - D. nationalism
  - E. mercantilism
3. Which of the following statements accurately characterizes mercantilism?
  - A. It is a new but largely discredited doctrine
  - B. It is a new, highly credible doctrine
  - C. It is an old yet highly credible doctrine
  - D. It is an old and largely discredited doctrine
  - E. It still influences many governments
4. The theory of \_\_\_\_\_ was advanced by Adam Smith.
  - A. absolute advantage
  - B. capitalism
  - C. similar opportunity
  - D. mercantilism
  - E. comparative advantage
5. Which of the following international trade scholars was the first to explain why unrestricted free trade is beneficial to a country?
  - A. Adam Smith
  - B. Bertil Ohlin
  - C. Eli Heckscher
  - D. Paul Krugman
  - E. David Ricardo
6. \_\_\_\_\_ refers to a situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.
  - A. Autonomous trade
  - B. Free trade
  - C. Clear commerce
  - D. Unencumbered commerce
  - E. NAFTA

7. \_\_\_\_\_, the first theory of international trade, principal assertion was that gold and silver were the mainstays of national wealth and essential to vigorous commerce.
- A. Collectivism's
  - B. Mercantilism's
  - C. Capitalism's
  - D. Economic conservatism's
  - E. Market capitalism
8. The main tenet of mercantilism was that it was in a country's best interest to maintain a:
- A. export and import trade balance
  - B. an import trade embargo
  - C. an export trade surplus
  - D. an export trade deficit
  - E. large reserve of gold
9. The flaw with mercantilism was that it viewed trade as a \_\_\_\_\_.
- A. zero-sum game
  - B. economic necessity
  - C. non essential economic activity
  - D. threat to a government's independence
  - E. luxury for consumers
10. \_\_\_\_\_ is not consistent with the central beliefs of mercantilism.
- A. Government should intervene to achieve a surplus in the balance of trade
  - B. Policies should be put in place to encourage exports and discourage imports
  - C. Imports should be limited by tariffs and quotas
  - D. Exports should be subsidized
  - E. Local manufacturing companies should be protected from foreign competition
11. According to David Hume, if England had a balance-of-trade surplus with France, the resulting inflow of gold and silver would:
- A. have no effect on England's economic conditions
  - B. increase the money supply and cause inflation in England
  - C. England's prices would fall
  - D. France's prices would rise
  - E. increase the wealth of the monarchy
12. A situation in which a gain by one party results in a loss by another is called a(n) \_\_\_\_\_.
- A. transfer of wealth
  - B. unbalanced scorecard
  - C. zero-sum game
  - D. positive-sum game
  - E. transaction
13. Hagelstam observed that in most trade negotiations, the approach of individual negotiating countries has been to press for trade \_\_\_\_\_ in areas where their own comparative competitive advantages are the strongest, and to resist \_\_\_\_\_ in areas where they are less competitive and fear that imports would replace domestic production.
- A. socialization; liberalization
  - B. capitalization; socialization
  - C. liberalization; liberalization
  - D. capitalization; capitalization
  - E. equality; growth

14. Which of the following is a situation in which all countries can benefit, even if some benefit more than others?
- A. Near equivalent-result game
  - B. Positive-sum game
  - C. Balanced scorecard
  - D. Zero-sum game
  - E. Economic progression
15. In his 1776 landmark book, *The Wealth of Nations*, \_\_\_\_\_ attacked the mercantilist assumption that trade is a zero-sum game.
- A. Geert Hofstede
  - B. Max Weber
  - C. Michael Porter
  - D. Adam Smith
  - E. David Ricardo
16. Which of the following international management scholars first argued that countries differ in their ability to produce goods efficiently?
- A. David Ricardo
  - B. Eli Heckscher
  - C. Michael Porter
  - D. Adam Smith
  - E. Raymond Vernon
17. According to Smith, countries should specialize in the production of goods for which they have an absolute advantage and then:
- A. retain these goods for strictly domestic sales
  - B. trade these goods for the goods produced by other countries
  - C. sell these goods to the highest domestic or international bidder
  - D. prohibit the import of these goods from other countries
  - E. stockpile these goods until international demand increases
18. \_\_\_\_\_ basic argument, articulated through the theory of absolute advantage, is that a country should never produce goods at home that it can buy at a low cost from another country.
- A. David Ricardo's
  - B. Michael Porter's
  - C. Bertil Ohlin's
  - D. Adam Smith's
  - E. John Vernon's
19. \_\_\_\_\_ is a situation in which one country is more efficient at producing a product than any other country.
- A. Absolute advantage
  - B. Relative advantage
  - C. Comparative advantage
  - D. Pertinent advantage
  - E. Favourable factor endowment
20. In his 1817 book entitled *Principles of Political Economy*, \_\_\_\_\_ introduced the theory of comparative advantage.
- A. Adam Smith
  - B. David Ricardo
  - C. Raymond Vernon
  - D. Max Weber
  - E. Michael Porter

21. A situation in which a country specializes in producing the goods it produces most efficiently and buys the products it produces less efficiently from other countries, even if it could produce the good more efficiently itself is referred to as:
- comprehensive advantage
  - pertinent advantage
  - comparative advantage
  - absolute advantage
  - inherent advantage
22. The theory of comparative advantage, advanced by \_\_\_\_\_, is the intellectual basis of the modern argument for unrestricted free trade.
- Michael Porter
  - David Ricardo
  - Bertil Ohlin
  - Adam Smith
  - Wassily Leontief
23. \_\_\_\_\_ is the basic message of the theory of comparative advantage.
- Potential world production is greater with unrestricted free trade than it is with restricted trade.
  - Potential world production is not significantly affected by trade policy.
  - Potential world production is greater with restricted trade.
- It makes sense for a country to specialize in the production of those goods that it produces most efficiently and to buy the goods that it produces less efficiently from other countries, unless this means buying goods from other countries that it could produce more efficiently itself.
- None of these answers is correct.
24. In terms of explaining why some countries export automobiles, consumer electronics, and machine tools, while other countries export chemicals, watches, and jewellery, David Ricardo's theory of comparative advantage offer an explanation in terms of
- international differences in intellectual capital.
  - international differences in labour productivity.
- The interplay between the proportions in which the factors of production (such as land, labour, and capital) are available in different countries and the proportions in which they are needed for producing particular goods.
- the cultural histories of the exporting nations.
  - the geographic location of potential trading partners
25. To an even greater degree than the theory of absolute advantage, the theory of \_\_\_\_\_ suggests that trade is a positive-sum game in which all gain.
- total advantage
  - mercantilism
  - comparative advantage
  - paradoxical advantage
  - eclectic paradigm
26. Ricardo's theory of comparative advantage suggests that consumers in all nations can consume more if there are
- trade restrictions on services only.
  - no trade restrictions.
  - severe trade restrictions.
  - trade restrictions on manufactured goods only.
  - restrictions on currencies

27. The theory of comparative advantage
- A. provides a strong rationale for encouraging international trade.
  - B. provides a strong rationale for discouraging international trade.
  - C. neither encourages nor discourages international trade.
  - D. provides a weak rationale for discouraging international trade.
  - E. is considered wrong by many
28. One of the limitations to the theory of comparative advantage is that resources do not always move easily from one economic activity to another and the process creates:
- A. inflation.
  - B. friction and human suffering.
  - C. new government regulations and higher taxes.
  - D. new product development.
  - E. excessive transportation costs and retraining concerns
29. Governments often ease the transition toward free trade by \_\_\_\_\_ those who lose their jobs as a result.
- A. offering welfare to
  - B. creating new jobs for
  - C. giving government jobs to
  - D. putting up temporary trade barriers
  - E. helping to retrain
30. Which of these occurs if an economy is opened to trade?
- A. Free trade might increase the efficiency with which a country uses its resources.
  - B. Economies of small-scale production would not be available as trade expands the size of the total . market available to domestic firms.
  - C. Free trade would decrease a country's stock of resources as increased supplies of labour and capital . from abroad become available for use within the country.
  - D. Domestic producers would be stimulated to look for new ways to increase their productivity.
  - E. Prices for consumer goods may increase
31. Dynamic gains in both the stock of a country's resources and the efficiency with which resources are utilized will cause a country's PPF to:
- A. shift inward
  - B. shift outward
  - C. make no appreciable change
  - D. no longer be influential
  - E. reflect new technologies
32. \_\_\_\_\_ argued that comparative advantage rises from differences in national factor endowments.
- A. Heckscher and Ohlin
  - B. Smith
  - C. Sachs and Warner
  - D. Ricardo
  - E. Porter
33. Frankel and Romer found that on average, a \_\_\_\_\_ percent increase in the ratio of a country's trade to its gross domestic product increases income per person by at least one-half percent.
- A. 10
  - B. 27
  - C. 1
  - D. 50
  - E. 2

34. Swedish economists, \_\_\_\_\_ and \_\_\_\_\_, advanced a theory of trade that argued that comparative advantage arises from differences in national factor endowments.
- Durbin; Coles
  - Heckscher; Ohlin
  - Delhomme; Rivette
  - Mouton; Penn
  - Borg; Abba
35. Which theory predicts that countries will export those goods that make intensive use of those factors that are locally abundant, while importing goods that make intensive use of factors that are locally scarce?
- Heckscher-Cormier
  - Ricardo-Olin
  - Heckscher-Olin
  - Carrier-Roller
  - Smith-Ricardo
36. Which of the following statements is a fair comparison of the Heckscher-Ohlin theory and the Ricardo theory (i.e. comparative advantage) of free trade?
- both theories argues that the pattern of international trade is determined by currency exchange rates
  - the Heckscher-Olin theory argues that the pattern of international trade is determined by trade endowments, while the Ricardo theory argues that the pattern of international trade is determined by differences in productivity
  - both theories argue that the pattern of international trade is determined by differences in productivity
  - the Heckscher-Olin theory argues that the pattern of international trade is determined by differences in productivity, while the Ricardo theory argues that the pattern of international trade is determined by trade endowments
  - the Heckscher-Olin theory argues that the pattern of international trade is determined by differences in demand conditions, while the Ricardo theory argues that the pattern of international trade is determined by national competitive advantages
37. Most economists, according to the textbook, prefer the Heckscher-Ohlin theory to Ricardo's theory (i.e. comparative advantage) because which of the following two factors?
- It makes fewer simplifying assumptions and it has been subjected to many empirical tests
  - It has been subjected to many empirical tests and it has stood the test of time
  - It makes fewer simplifying assumptions and it has been acknowledged by the World Trade Organization as the better of the two theories
  - It has been acknowledged as the better of the two theories by the World Trade Organization, and it has stood the test of time
  - Ricardo's theory is almost 200 years old, while Heckscher-Ohlin's theory is quite modern
38. The Heckscher-Olin theory argues that the pattern of international trade is determined by differences in:
- productivity
  - political interests
  - factor endowments
  - national priorities
  - first mover advantages
39. The Heckscher-Ohlin theory has a(n) \_\_\_\_\_ appeal.
- political
  - commonsense
  - economic
  - cost efficiency
  - historical

40. The Heckscher-Ohlin theory \_\_\_\_\_ in explaining why some countries export oil while others export textiles.
- A. emphasizes the interplay between the proportions in which the factors of production (such as land, labour, and capital) are available in different countries
  - B. emphasizes international differences in labour productivity
  - C. emphasizes international differences in intellectual capital
  - D. emphasizes international differences in cultural histories
  - E. emphasizes the difference in living standards of consumers
41. One early response to the failure of the Heckscher-Ohlin theory to explain the observed pattern of international trade was the \_\_\_\_\_.
- A. theory of rising costs
  - B. product life-cycle theory
  - C. theory of comparative advantage
  - D. theory of cultural constraints
  - E. the Leontieff Paradox
42. Which of the following choices correctly matches a scholar with the theory that he or she proposed?
- A. Adam Smith/Comparative Advantage
  - B. David Ricardo/New Trade
  - C. Raymond Vernon/Product Life Cycle
  - D. Eli Heckscher/Absolute Advantage
  - E. Michael Porter/Factor Endowment
43. Contrary to what the Heckscher-Ohlin theory would predict, the United States has been a primary importer rather than an exporter of capital goods. This phenomenon is referred to as the \_\_\_\_\_ paradox.
- A. Theler
  - B. Leontief
  - C. Cormier
  - D. Ricardo
  - E. Porter
44. What is a possible explanation for observing the Leontief paradox?
- A. The Leontief paradox makes perfect sense.
  - B. The U.S. has a special advantage in producing new products or goods made with innovative technologies.
  - C. Other countries don't have the technologies that the U.S. has.
  - D. Labour costs are much lower in developing countries
  - E. For many products the market size is much larger in India and China.
45. Who initially proposed the product life-cycle theory in the mid-1960s?
- A. Cormier
  - B. Heckscher
  - C. Vernon
  - D. Smith
  - E. Porter
46. Vernon's product life-cycle theory was based on the observation that for most of the 20<sup>th</sup> century a very large proportion of the world's new products had been developed by U.S. firms and sold first in the \_\_\_\_\_ market.
- A. Japanese
  - B. Western European
  - C. U.S.
  - D. Canadian
  - E. South American market

47. As the market in the U.S. and other advanced nations matures, the product becomes more standardized and price becomes:
- A. governmentally regulated.
  - B. greater.
  - C. unimportant.
  - D. the main competitive weapon.
  - E. more differentiated
48. \_\_\_\_\_ theory of international trade suggests that the production of products is likely to switch from advanced countries to developing countries over time.
- A. New trade
  - B. Comparative advantage
  - C. Heckscher-Ohlin
  - D. Product life-cycle
  - E. Competitive advantage
49. According to the textbook, historically the product-life-cycle theory is an:
- A. accurate explanation of international trade patterns for manufactured goods but not for services
  - B. accurate explanation of international trade patterns
  - C. accurate explanation of international trade patterns in some countries but not in others
  - D. inaccurate explanation of international trade patterns
  - E. accurate explanation of international travel and transportation volumes
50. \_\_\_\_\_ is/are unit cost reductions associated with a large scale of output.
- A. Product life-cycle
  - B. Economies of scale
  - C. Learning effects
  - D. First-mover advantage
  - E. Late-mover volumes
51. Because of substantial economies of scale, the \_\_\_\_\_ theory argues that in many industries there are increasing returns to specialization.
- A. Leontief's paradox
  - B. product life-cycle
  - C. new trade
  - D. Heckscher-Ohlin
  - E. Porter
52. The \_\_\_\_\_ theory argues that due to the presence of substantial scale economies, world demand will support only a few firms in many industries.
- A. Heckscher-Ohlin
  - B. Leontief's paradox
  - C. product life-cycle
  - D. new trade
  - E. Porter
53. Which theory of international trade directly explains why there are only two to three producers of airlines in the world today?
- A. absolute advantage
  - B. new trade
  - C. comparative advantage
  - D. product life cycle
  - E. mercantilism

54. Cost savings that come from learning by doing is referred to as:
- A. economies of scale.
  - B. first-mover advantage.
  - C. learning effects.
  - D. factor endowments.
  - E. late-mover advantage
55. Learning effects were first documented in the aerospace industry where it was found that each time accumulated output of airframes was doubled, unit costs declined to \_\_\_\_\_ percent of their previous level.
- A. 90
  - B. 80
  - C. 50
  - D. 40
  - E. 60
56. The economic and strategic advantages that accrue to early entrants in an industry are called:
- A. first-mover advantages
  - B. initial-class advantages
  - C. early-entrant advantages
  - D. first-stage benefits
  - E. initial-entrant advantage
57. The new trade theorists argue that the United States leads in exports of commercial jet aircraft not because it is better endowed with the factors of production required to manufacture aircraft, but because:
- A. U.S. built commercial jet aircraft have the best safety record
  - B. the U.S. commercial jet aircraft industry has a lower wage rate than foreign competitors
  - C. the World Trade Organization has given preferential treatment to the U.S. commercial jet aircraft industry
  - D. one of the first movers in the industry was DeHavilland
  - E. one of the first movers was Boeing
58. According to the new trade theorists, because early entrants are able to gain \_\_\_\_\_, the early entrants into an industry may get a lock on the world market that discourages subsequent entry.
- A. high brand awareness
  - B. highly skilled employees
  - C. high legitimacy
  - D. economies of scale
  - E. market penetration
59. Economies of scale and learning effects both increase the efficiency of resource utilization, therefore increasing
- A. costs.
  - B. capital.
  - C. factor endowments.
  - D. productivity.
  - E. profitability
60. New trade theorists stress the role of the following three variables in giving firm first-mover advantages?
- A. availability of capital, entrepreneurship, and favourable government policies
  - B. entrepreneurship, favourable foreign exchange rates, and innovation
  - C. luck, entrepreneurship, and innovation
  - D. modernization, luck, and the availability of capital
  - E. availability of capital, low labour costs and innovation

61. Which theory stresses that in some cases countries specialize in the production and export of particular products not because of underlying differences in factor endowments but because in certain industries the world market can support only a limited number of firms?
- A. Balanced trade
  - B. Heckscher-Olin
  - C. New trade
  - D. Product life-cycle
  - E. National competitive advantage
62. The New Trade Theory began to emerge in the \_\_\_\_\_
- A. 1960s
  - B. 1970s
  - C. 1980s
  - D. 1990s
  - E. 2000s
63. The theory of \_\_\_\_\_, developed by Michael Porter, focuses on the importance of country factors such as domestic demand and domestic rivalry in explaining a nation's dominance in the production and export of particular products.
- A. new trade
  - B. absolute advantage
  - C. comparative advantage
  - D. national competitive advantage
  - E. factor endowments
64. Which of the following two theories justify some limited and selective government intervention to support the development of certain export-oriented industries?
- A. The theory of national competitive advantage and the Heckscher-Ohlin theory
  - B. The theory of absolute advantage and the new trade theory
  - C. The Heckscher-Ohlin theory and theory of comparative advantage
  - D. The theory of mercantilism and the Heckscher-Ohlin theory
  - E. The new trade theory and theory of national competitive advantage
65. According to the new trade theory, the reason Boeing was the first mover in commercial jet aircraft manufacture was that Boeing was
- A. lucky and innovative.
  - B. creative and showed bureaucracy.
  - C. bureaucratic and entrepreneurial.
  - D. cash rich.
  - E. the only company large enough to assume the risk
66. In 1990, who published the results of an intensive research effort that attempted to determine why some nations succeed and others fail in international competition?
- A. Eli Heckscher
  - B. Michael Porter
  - C. Bertil Ohlin
  - D. Raymond Vernon
  - E. Wassily Leontief
67. \_\_\_\_\_, according to Michael Porter, are a nation's position in factors of production such as skilled labour or the infrastructure necessary to compete in a given industry.
- A. Demand endowments
  - B. Factor endowments
  - C. Factor competencies
  - D. Demand conditions
  - E. National resources

68. The conditions governing how companies are created, organized, and managed and the nature of domestic rivalry is referred to as
- A. relating and supporting industries.
  - B. demand conditions.
  - C. factor endowments.
  - D. firm strategy, structure, and rivalry.
  - E. corporate regulations
69. Porter's thesis was that four broad attributes of a nation shape the environment in which local firms compete, and that these attributes promote or impede the creation of competitive advantage. All of the following is/are attributes except:
- A. factor endowments
  - B. customs
  - C. firm strategy, structure, and rivalry
  - D. related and supporting industries
  - E. demand conditions
70. Porter argued that in regard to factor endowments, \_\_\_\_\_ factors are the most significant for competitive advantage in his study dealing with the competitive advantage of nations.
- A. standard
  - B. basic
  - C. advanced
  - D. complementary
  - E. exclusive
71. Unlike the naturally endowed basic factors, advanced factors are a product of investment by all of the following except
- A. companies.
  - B. governments.
  - C. demographics.
  - D. individuals.
  - E. none of these answers is correct
72. In his study dealing with the competitive advantage of nations, Porter argued that in regard to demand conditions, a nation's firms' gain competitive advantage if their domestic consumers are \_\_\_\_\_ and \_\_\_\_\_.
- A. unpretentious; passive
  - B. modest; passive
  - C. exacting; unpretentious
  - D. sophisticated; demanding
  - E. fractious; unsatisfied
73. Who argued that successful industries within a country tend to be grouped into "clusters" of related industries?
- A. Porter
  - B. Vernon
  - C. Ricardo
  - D. Heckscher
  - E. Sachs
74. In his study, Porter observed that there are a disproportionate number of people with finance backgrounds on the top management teams of many \_\_\_\_\_ industries.
- A. Japanese
  - B. French
  - C. United States
  - D. South Korean
  - E. German

75. \_\_\_\_\_ occurs(s) when employees move between firms within a region and when national industry associations bring employees from different companies together for regular conferences or workshops.
- A. Employee competition
  - B. Espionage
  - C. Knowledge flows
  - D. First-mover advantage
  - E. industrial espionage
76. Domestic rivalry creates pressure to do all of the following except:
- A. to innovate.
  - B. to reduce costs.
  - C. to improve employee relations.
  - D. to invest in upgrading advanced factors.
  - E. to improve efficiency
77. \_\_\_\_\_, by its choice of policies, can detract from or improve national advantage.
- A. A company
  - B. Government
  - C. A market
  - D. Individuals.
  - E. Shareholders
78. Porter argues that the presence of all components is usually required for the "diamond" to boost:
- A. international recognition.
  - B. competitive performance.
  - C. corporate social responsibility.
  - D. employee morale.
  - E. national export surpluses
79. We would expect Porter's model to predict \_\_\_\_\_, if he is correct.
- A. currency exchange rates
  - B. membership in the World Trade Organization
  - C. the pattern of international trade
  - D. factor endowments
  - E. trade costs
80. The success of the rose industry in Ecuador is a good example of the economic benefits of free trade  
True False
81. Propagated in the 16<sup>th</sup> and 17<sup>th</sup> centuries, mercantilism advocated that countries should discourage both imports and exports.  
True False
82. Free trade is a situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.  
True False
83. The great strength of the theories of Smith, Ricardo, and Heckscher-Ohlin is that they identify the specific benefits of international trade.  
True False
84. The product life-cycle theory stresses that in some cases, countries specialize in the production and export of particular products not because of underlying differences in factor endowments but because in certain industries the world market can support only a limited number of firms.  
True False

85. The first theory of international trade emerged in England in the mid-16<sup>th</sup> century. Referred to as the theory of comparative advantage, its principle assertion was that gold and silver were the mainstays of national wealth and essential to vigorous commerce.  
True False
86. The flaw with mercantilism was that it viewed trade as a zero-sum gain.  
True False
87. A situation in which a gain by one country results in a loss by another is a positive-sum game.  
True False
88. When a country is more efficient than any other country in producing a product, it has absolute advantage in the production of that product  
True False
89. In his 1776 landmark book, *The Wealth of Nations*, Adam Smith supported the mercantilist assumption that trade is a zero-sum game.  
True False
90. Smith's basic argument was that a country should never produce goods at home that it can buy at a lower cost from other countries.  
True False
91. Ricardo's theory of competitive advantage says that it is logical for a country to specialize in the product of goods that it produces most efficiently and to export goods that it produces less efficiently.  
True False
92. The theory of absolute advantage suggests that trade is a positive-sum game in which all can gain to an even greater degree than the theory of comparative advantage.  
True False
93. The potential world production is greater with unrestricted free trade than it is with restricted free trade is the basic message of the theory of comparative advantage.  
True False
94. When a movement toward a free trade regime occurs, the pain is a long-term phenomenon, while the gains from trade, once the transition has been made, are both insignificant and short-term.  
True False
95. Economic growth is positively affected by free trade.  
True False
96. Like Ricardo's theory, the Heckscher-Ohlin theory argues that free trade is beneficial. Unlike Ricardo's theory, however, the Heckscher-Ohlin theory argues that the pattern of international trade is determined by differences in factor endowments, rather than differences in productivity.  
True False
97. The Heckscher-Ohlin theory would predict that the United States should be a primary importer of capital goods.  
True False
98. Because it makes fewer simplifying assumptions, and it has been subjected to many empirical tests, most economists prefer the Heckscher-Ohlin theory to Ricardo's theory.  
True False
99. The Heckscher-Ohlin theory has been one of the least influential in international economics.  
True False

100. Raymond Vernon's theory of the Product Life-Cycle was based on the observation that for most of the 20<sup>th</sup> century a very large proportion of the world's new products were developed by U.S. firms and sold first in the U.S. market.  
True False
101. The new trade theorists argue that in those industries where the existence of substantial economies of scale imply that the world market will profitable support only a few firms, countries may export certain products simply because they have a firm that was an early entrant into that industry.  
True False
102. Both economies of scale and learning effects increase the efficiency of resource utilization, but do not affect productivity.  
True False
103. According to Porter, the four broad attributes of a nation that shape the environment in which local firms compete and that promote or impede the creation of competitive advantage are demand conditions, firm strategy, structure, and rivalry, factor endowments, and relating and supporting industries.  
True False
104. In sum, Porter's argument is that the degree to which a nation is likely to achieve international success in a certain industry is a function of the combined impact of factor endowments, domestic demand conditions, related and supporting industries, and degree of government support.  
True False
105. The importance to firms of building and exploiting first-mover advantages is suggested by the new trade theory.  
True False
106. A firm should invest in upgrading advanced factors of production because it is in the best interest of business for a firm, according to Porter's theory.  
True False
107. What is meant by the term "free trade?" Was Adam Smith an advocate or critic of free trade? Is free trade compatible with the concept of mercantilism? Explain your answer.
108. When does free trade occur?
109. Describe Adam Smith's concept of absolute advantage.

110. Describe the Heckscher-Ohlin theory of international trade. Is the Heckscher-Ohlin theory consistent with the notion of free trade? Why or why not?
111. Describe the central tenant of the product life-cycle theory.
112. Describe the new trade theory. How does the new trade theory help us to understand why the United States is dominant in the world market for commercial aircraft exports?
113. Describe what is meant by first-mover advantages?
114. In an extensive study that was published in a book entitled *The Competitive Advantage of Nations*, Michael Porter concluded that four broad attributes of a nation shape the environment in which local firms compete, and that these attributes promote or impede the creation of competitive advantage. Identify and describe the four attributes advanced by Porter. What did Porter conclude from his analysis?

115. Globalization is described as the creation of a single world market. You can see evidence of globalization in every store, and in most products. You can also see it in the shifting of labour intensive industry to low wage cost countries. As Canadians we are generally in support of free trade. Using appropriate trade theories explain why freer trade is particularly beneficial to Canada and to our trading partners.
116. In the first years of the expansion of NAFTA to include Mexico many companies had compelling reasons for opening a plant in Mexico. The Mexican government was enticing some businesses with incentives such as no taxes and free land. What international trade theory could justify this action? Explain.
117. Porter considered four factors of production in developing his theory of international trade. These four factors help determine the difference in production between different countries. Describe and explain the four factors. Explain which factor would be more important and why for computer chips and hand made shoes.
118. China, like Japan as well as other countries, have often been accused of applying neo-mercantilist policies. They see an export-driven economy as the way to wealth and want to restrict exports as much as possible. An example of this is China's desire to develop a home grown microprocessor industry so that it will not have to import chips from other countries. Is this an example of mercantilism? Explain.
119. Despite apparent unanimity throughout the world about the desirability of free trade, managed trade is the rule. Mercantilism thrives and has adapted to the economic world of the 1990s. Corporations have replaced nations as the driving force behind efforts to manage the international trade system. Do you agree or disagree with this statement? Explain using appropriate trade theories.

120. Nokia success is hard to understand when you realize that their domestic base is a country of 5 million people with a GNI less than that of Ontario. What are the reasons for Nokia's success?

## Chapter 5 Key

1. (*p. 162, 163*) A
2. (*p. 165*) E
3. (*p. 165*) E
4. (*p. 165*) A
5. (*p. 165*) A
6. (*p. 165*) B
7. (*p. 168*) B
8. (*p. 168*) C
9. (*p. 168*) A
10. (*p. 168*) B
11. (*p. 168*) B
12. (*p. 168*) C
13. (*p. 168*) C
14. (*p. 168*) B
15. (*p. 168*) D
16. (*p. 168*) D
17. (*p. 169*) B
18. (*p. 169*) D
19. (*p. 169*) A
20. (*p. 170*) B
21. (*p. 170, 171*) C
22. (*p. 171*) B
23. (*p. 170-173*) A
24. (*p. 171*) B
25. (*p. 171-173*) C
26. (*p. 173*) B
27. (*p. 173-175*) A
28. (*p. 173, 174*) B
29. (*p. 174*) E
30. (*p. 175*) A
31. (*p. 171*) B
32. (*p. 177*) A
33. (*p. 177*) C
34. (*p. 177*) B
35. (*p. 177*) C
36. (*p. 177*) B

37. (p. 177) A
38. (p. 177) C
39. (p. 177) B
40. (p. 177) A
41. (p. 177, 178) B
42. (p. 178) C
43. (p. 177, 178) B
44. (p. 177, 178) B
45. (p. 178) C
46. (p. 178, 179) C
47. (p. 179) D
48. (p. 178) D
49. (p. 179) B
50. (p. 181) B
51. (p. 181) C
52. (p. 181) D
53. (p. 181) B
54. (p. 181) C
55. (p. 181) B
56. (p. 178, 179, 188) A
57. (p. 181, 188) E
58. (p. 181) D
59. (p. 181) D
60. (p. 181) C
61. (p. 181) C
62. (p. 181) B
63. (p. 183) D
64. (p. 183, 184) E
65. (p. 181) A
66. (p. 183) B
67. (p. 184) B
68. (p. 184) D
69. (p. 184) B
70. (p. 185) C
71. (p. 185) C
72. (p. 185) D
73. (p. 185, 186) A
74. (p. 186) C

75. (p. 185, 186) C

76. (p. 186) C

77. (p. 187) B

78. (p. 186, 187) B

79. (p. 187) C

80. (p. 162, 163) TRUE

81. (p. 165) FALSE

82. (p. 165) TRUE

83. (p. 165) TRUE

84. (p. 165, 166) FALSE

85. (p. 170) FALSE

86. (p. 168) TRUE

87. (p. 168) FALSE

88. (p. 169) TRUE

89. (p. 169) FALSE

90. (p. 169) TRUE

91. (p. 170, 171) FALSE

92. (p. 169, 171) FALSE

93. (p. 171-173) TRUE

94. (p. 173) FALSE

95. (p. 176) TRUE

96. (p. 177) TRUE

97. (p. 177) FALSE

98. (p. 177) TRUE

99. (p. 177) FALSE

100. (p. 178) TRUE

101. (p. 181) TRUE

102. (p. 181) FALSE

103. (p. 184) TRUE

104. (p. 184) FALSE

105. (p. 181) TRUE

106. (p. 184, 185) TRUE

107. (p. 165-170) Free trade refers to a situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country. This concept was supported by Adam Smith, who argued that the "invisible hand" of the market mechanism, rather than government policy, should determine what a country imports and what it exports. The concept of mercantilism is not compatible with the concept of free trade. The main tenet of mercantilism is that it is in a country's best interests to maintain a trade surplus by exporting more than it imports. Consistent with this belief, the mercantilist doctrine advocated government intervention to achieve a surplus in the balance of trade.

108. (p. 165) Free trade occurs when a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.

109. (p. 168-170) According to Smith, countries should specialize in the production of goods for which they have an absolute advantage and then trade those goods for the goods produced by other countries. For instance, during Smith's time, England had an absolute advantage in the production of textiles, and France had an absolute advantage in the production of wine. According to the concept of absolute advantage, it then only makes sense for England to produce textiles (and export them to France), and France to produce wine (and export it to England). Smith's basic argument, therefore, was that a country should never produce goods at home that it can buy at a lower cost from other countries. Moreover, Smith argued that by specializing in the production of goods in which each has an absolute advantage, both countries benefit by engaging in trade.

110. (p. 177) The Heckscher-Ohlin theory predicts that countries will export those goods that make intensive use of those factors that are locally abundant, while importing goods that make intensive use of factors that are locally scarce. Thus, the Heckscher-Ohlin theory attempts to explain the pattern of international trade that we see in the world economy. The Heckscher-Ohlin theory is consistent with the notion of free trade. It also has commonsense appeal, and there are many examples of international commerce that are supportive of the theory.

111. (p. 178-180) Proposed by Raymond Vernon, the product life-cycle theory suggests that early in their life cycle, most new products are produced in an exported from the country in which they were developed. As a new product becomes widely accepted internationally, production starts in other countries. As a result, the theory suggests, the product may ultimately be exported back to the country of its innovation.

This theory helps us understand why the United States is dominant in the world market for commercial aircraft exports. American firms such as Boeing were first movers in the world market in the commercial aircraft industry. As a result, Boeing and to a lesser extent other American firms built a competitive advantage that has subsequently been difficult for firms from countries with equally favourable factor endowments to challenge.

112. (p. 181-182) The new trade theory stresses that in some cases countries specialize in the production and export of particular products not because of underlying differences in factor endowments, but because in certain industries, the world market can support only a limited number of firms. In such industries, firms that enter the market first build a competitive advantage that is difficult to challenge. Thus, the observed pattern of trade between nations may in part be due to the ability of firms to capture first-mover advantages.

113. (p. 188) First mover advantages are the economic and strategic advantages that accrue to early entrants into an industry. Because they are able to gain economies of scale, early entrants may get a lock on the world market that discourages subsequent entry. In other words, the ability of first-movers to reap economies of scale creates a barrier to entry. In the commercial aircraft industry, for example, the fact that Boeing and Airbus are already in the industry and have achieved substantial economies of scale effectively discourages new entrants.

Porter speaks of these four attributes as constituting the diamond. He argues that firms are most likely to succeed in industries or industry segments where the diamond is most favourable.

Firm Strategy, Structure, and Rivalry: The conditions in the nation governing how companies are created, organized, and managed and the nature of domestic rivalry.

Related or Supporting Industries: The presence or absence in a nation of supplier industries and related industries that are internationally competitive.

Demand Conditions: The nature of home demand for the industry's product or service.

Factor Endowments: A nation's position in factors of production such as skilled labour or the infrastructure necessary to compete in a given industry.

114. (p. 184) The four attributes identified by Porter are as follows:

115. (p. 165-184) This requires the student to understand how important trade is to the Canadian economy. Canada is among the countries that is most dependent on trade as a percentage of GNI. In 2004 it was approximately 47% of GNI. This means that we are very dependent on free trade, as the more barriers to trade the lower the volume of trade. It also means that the theory of comparative advantage is very attractive to any arguments and the fundamental argument we might make with our trading partners. A variation of this argument would be to use Heckscher-Ohlin. The student could also argue that Porter's national competitive advantage, also supports freer trade as the four factors determine the type of activity that is most appropriate for a given country. It also allows the government to intervene in improving the conditions.

116. (p. 187) Porter's National Competitive Advantage does argue that governments can affect the effectiveness of various factors by employing a variety of policy tools. For example, in terms of advanced factors of endowment the government could subsidize education.

Hand made shoes would more likely be affected by the cost of labour and demand conditions.

Computer Chips would most likely be more affected by advanced factors such as education and the availability of skilled labour. They would also be more likely to be influenced by the related or supporting industry factor, because of the technological need for continuous innovation.

**Firm Strategy, Structure, and Rivalry:** The conditions in the nation governing how companies are created, organized, and managed and the nature of domestic rivalry.

**Related or Supporting Industries:** The presence or absence in a nation of supplier industries and related industries that are internationally competitive.

**Demand Conditions:** The nature of home demand for the industry's product or service.

**Factor Endowments:** A nation's position in factors of production such as skilled labour or the infrastructure necessary to compete in a given industry.

117. (p. 184-186) The four attributes identified by Porter are as follows:

118. (p. 168) The student could argue that this is mercantilism, but they could also argue that this reflects the infant industry argument.

119. (p. 165-184) There are any number of examples of corporations/industries using the slogan of free trade should mean fair trade. The fair trade in this case generally implies restrictions on foreign companies competing in the marketplace. One of the best known examples of this is the Canadian-U.S. softwood lumber dispute.

**Firm Strategy, Structure, and Rivalry:** The conditions in the nation governing how companies are created, organized, and managed and the nature of domestic rivalry. The presence of Erickson another large telecommunications company located in Sweden meant for intense competition for a relatively small market.

**Demand Conditions:** The nature of home demand for the industry's product or service. The Finnish/Scandinavian market is very sophisticated in the telecommunications sector. The geography affects this. Long distances, traditional telephone wiring/connections very expensive to make available to isolated communities or homes. Also Scandinavians like the latest gadgets and amenities.

120. (p. 188-189) The student should refer to Porter's diamond and mention the following factors:

## Chapter 5 Summary

<u>Category</u>	<u># of Questions</u>
Difficulty: Easy	25
Difficulty: Hard	21
Difficulty: Medium	74
Hill - Chapter 05	120