

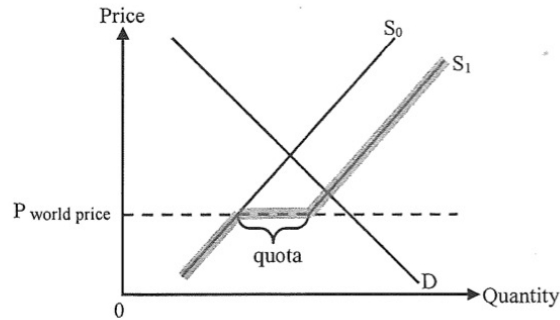
43. The following table shows the production and consumption data in Country A, which only produces and consumes clothing (C) and food (F).

	Clothing (units)	Food (units)
Total production WITHOUT trade	10	60
Total production with specialisation	60	0
Total consumption with trade	20	120

The terms of trade is _____.

- A. $1C = 2F$
- B. $1C = 3F$
- C. $1C = 5F$
- D. $1C = 6F$

44. The diagram below is about a small open economy imposing an import quota on Good X.



If the world price of Good X drops,

- A. the quota will become ineffective.
- B. the quantity of Good X produced domestically will decrease.
- C. the quantity of Good X consumed domestically will increase.
- D. the domestic price of Good X will remain unchanged.

7. In a two-country-two-good model, the outputs per unit of resources of both countries are as follows.

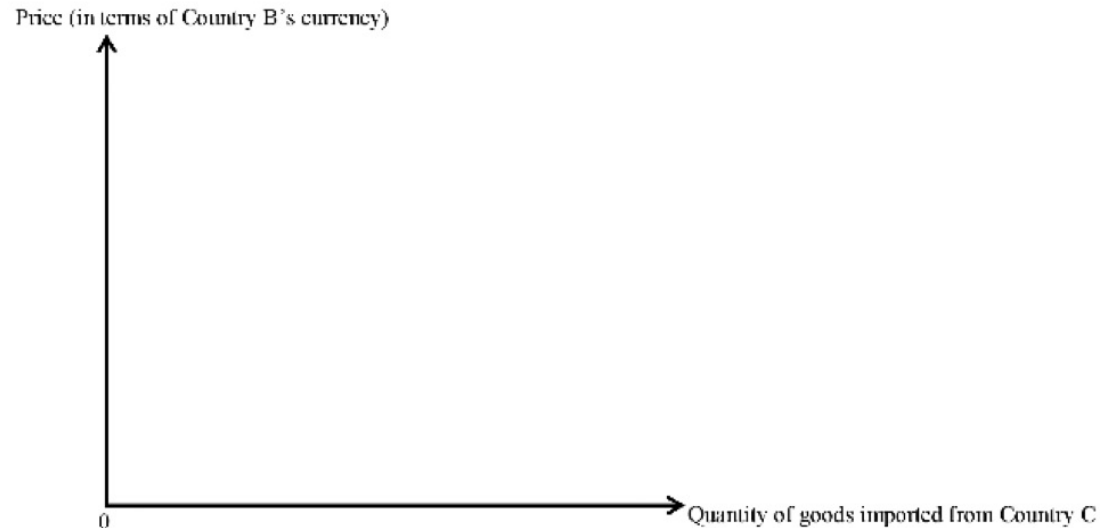
	Rice (units)	OR	Toys (units)
Country E	10	OR	20
Country F	5	OR	15

- (a) Assume the terms of trade are that 1 unit of rice can be exchanged for 2.2 units of toys. Calculate the gains from trade of **EACH** country when trading 1 unit of rice. Show your workings. (4 marks)
- (b) With reference to your answer in part (a), defend the following statement, 'There is still a basis for trade even if a country has no absolute advantage in producing any goods.' (2 marks)

4. Country B and Country C are two large open economies. Facing a huge visible trade deficit, Country B imposes a per-unit tariff on goods imported from Country C. Suppose Country B's demand for goods imported from Country C is elastic.

- (a) With the aid of Figure 1, explain how the tariff would affect the total expenditure of Country B on goods imported from Country C. (6 marks)
- (b) "Devaluation of a country's currency against its trading partners' may have the same effect on imports as tariff." Use Country B as an example to justify this statement. (2 marks)
- (c) Apart from the effect on the country's visible trade balance, explain **ONE** other effect of devaluation on its balance of payments. (2 marks)

Figure 1: Goods imported from Country C by Country B



SECTION 7: INTERNATIONAL TRADE

7.1 GAINS FROM FREE TRADE

Multiple Choice Questions

1990/CE/II/42

A country gains from trade because

- A. it obtains goods at a lower opportunity cost.
- B. it collects tariff revenue.
- C. it exports more than it imports.
- D. it specializes in producing goods in which it enjoys an absolute advantage.

1990/CE/II/48

The table below shows the production of two goods in two countries:

	One unit of resources can produce	
	Clothes (units)	Toys (units)
Country X	10	5
Country Y	2	1

Suppose there are no barriers to trade between the two countries,

- A. X will export clothes and toys to Y.
- B. X will export clothes and import toys from Y.
- C. Y will export toys and import clothes from X.
- D. neither country will benefit from their mutual trade.

1991/CE/II/53

The following table shows the number of man-hours required for the production of two goods X and Y in Countries A and B.

	Country A	Country B
1 unit of X	1 man-hour	2 man-hours
1 unit of Y	3 man-hours	4 man-hours

According to the principle of comparative advantage,

- A. Country A will export X and import Y.
- B. Country A will export Y and import X.
- C. Country A will import X and Y from Country B.
- D. Country A will export X and Y to Country B.

1992/CE/11/51
Refer to the following table:

	Toys (units)		Machinery (units)
HK's output per man-hour	30	OR	20
U.S.A.'s output per man-hour	50	OR	40

- (1) The U.S.A. has an absolute advantage in producing both goods.
 - (2) The U.S.A. has an absolute advantage in producing machinery only.
 - (3) Hong Kong has a comparative advantage in producing toys.
 - (4) Hong Kong has a comparative advantage in producing machinery.
- A. (1) and (3) only
B. (1) and (4) only
C. (2) and (3) only
D. (2) and (4) only

1992/CE/11/53
International trade is beneficial to a country if

- A. that country exports more than it imports.
- B. that country imports more than it exports.
- C. it allows a more efficient use of resources.
- D. it enables the government to collect tariff revenue.

1993/CE/11/52

Country	Output per unit of resources	
	Wheat (units)	Cotton (units)
X	2	OR 4
Y	1	OR 3

According to the above table, country X has a _____ opportunity cost in producing wheat and country Y has a comparative advantage in producing _____. Therefore, country Y will import _____ from country X.

- A. lower cotton wheat
- B. lower wheat cotton
- C. higher wheat wheat
- D. higher cotton cotton

1994/CE/11/52
Suppose a country has an absolute advantage in good X. Which of the following is correct?

- A. It is possible that the country has a higher opportunity cost of producing good X than another country.
- B. The country can produce a greater amount of good X than another good with the same amount of resources.
- C. The country will also have a comparative advantage in good X.
- D. The country will have an absolute disadvantage in another good.

1994/CE/11/53
The following table shows the production of two goods in two countries:

	One unit of resources can produce	
	Clocks	Toys
Country A	2	OR 4
Country B	6	OR 8

Suppose 1 unit of clocks can be exchanged for 2 units of toys through trade,

- A. Both A and B will gain from trade.
- B. Both A and B will not gain from trade.
- C. A will not gain from trade.
- D. B will not gain from trade.

1995/CE/11/51
If a country has a comparative advantage in good X, it will

- A. have an absolute advantage in X.
- B. have a comparative disadvantage in some other good(s).
- C. specialize in producing X and export all its output of X to other countries.
- D. completely specialize in the production of X.

1995/CE/11/52
Suppose in Country A one unit of resources can produce either 1 unit of X or 3 unit of Y. If from trade 1 unit of X can exchange for 2 units of Y, Country A will export _____ and gain _____ for each unit of export.

- A. X 1 unit of Y
- B. X 1/6 units of Y
- C. Y 1 unit of X
- D. Y 1/6 units of X

1996/CE/11/46
Given a unit of input, the amount of output produced by Countries A and B are shown below:

	Garment (units)		Shoes (units)
Country A	2	OR	6
Country B	4	OR	8

Which of the following is/are true?

- (1) The opportunity cost of producing shoes in Country B is lower than that of Country A.
 - (2) Country B enjoys absolute advantage in the production of both goods.
 - (3) If trading opportunities were opened up, Country B would export garment and import shoes.
- A. (1) only
B. (3) only
C. (1) and (2) only
D. (2) and (3) only

1996/CE/11/47
A country will gain from international trade if

- A. it specializes in producing goods in which it enjoys comparative advantage.
- B. the price of its exports is higher than that of its imports.
- C. the quantity of its exports is greater than the quantity of its imports.
- D. the price of its imports is less than the unit cost of producing these goods itself.

1996/CE/II/53

Which of the following economic principles can best explain why a doctor, who is the fastest typist in town, chooses to employ a typist to do all the typing for him?

- A. economies of scale
- B. comparative advantage
- C. diversification of work
- D. law of diminishing returns

1997/CE/II/53

Suppose the production of cars and shirts in Mainland China and in the U.S.A. is as follows:

	One unit of resources can produce	
	Car (units)	Shirts (units)
Mainland China	1	OR 4
U.S.A	2	OR 3

Suppose Hong Kong is willing to exchange 45 units of shirts for 9 units of cars. Under free trade, in order to obtain the maximum gain per unit of export/import,

- A. Mainland China would export shirts to Hong Kong.
- B. The U.S.A. would export cars to Hong Kong.
- C. Hong Kong would import shirts from the U.S.A.
- D. Mainland China would import shirts from the U.S.A.

Question 43 and 44 refer to the table below. Suppose there are only two countries, Country A and Country B. The output of bananas and shoes per unit of input of the two countries are as follows:

	Bananas (Units)	Shoes (Units)
Country A	4	OR 12
Country B	2	OR 4

1998/CE/II/43

Which of the following statements is correct?

- A. Country A has both an absolute and comparative advantage in the production of bananas.
- B. Country A will export shoes.
- C. Country B will import bananas.
- D. Both countries will gain if 1 unit of bananas is exchanged for 4 units of shoes.

1998/CE/II/44

There are 4 units of resources in each country. Before trade, both countries use 1 unit of input to produce bananas and 3 units to produce shoes. If complete specialization takes place in the two countries, what will be the change in the total output of bananas and shoes of the two countries?

- A. Only the production of bananas will increase.
- B. Only the production of shoes will increase.
- C. The production of bananas will increase but the production of shoes will decrease.
- D. The production of both bananas and shoes will increase.

1998/CE/II/45

If Country X can produce the same amount of each good with less resources than Country Y, then

- A. there is no favourable terms of trade between Country X and Country Y.
- B. Country Y may still produce some goods at a lower opportunity Costs.
- C. trade can still take place based on absolute advantage.
- D. Country X possesses comparative advantage on all goods.

1999/CE/II/46

If a country specializes and exports good X, it implies that

- A. The country needs to give up less of other goods than other countries in order to produce good X.
- B. This country has more resources than other countries for producing good X.
- C. This country uses less resources than other countries for producing the same amount of good X.
- D. This country can produce good X at a lower cost than other goods.

1999/CE/II/48

Suppose the output per man-hour of China, Japan and the US are as follows:

	DVD (units)	VCD (Units)
China	10	OR 30
Japan	20	OR 20
U.S.	30	OR 50

According to the table,

- A. The US has a comparative advantage in producing both goods.
- B. The US has a comparative advantage in producing VCDs only.
- C. China has a comparative advantage in producing DVDs only.
- D. Japan has a comparative advantage in producing DVDs only.

2000/CE/II/46

Suppose there are good X and good Y only. If a country has a comparative advantage in good X, it will have

- A. an absolute advantage in Y.
- B. an absolute disadvantage in Y.
- C. a comparative advantage in Y too.
- D. a higher opportunity cost in producing Y.

Answer questions 47 and 48 by referring to the following table. It shows the amount of resources (in man-hours) required to produce 1 unit of good X or 1 unit of good Y in country A and country B, respectively.

	Good X	Good Y
Country A	1	2
Country B	3	4

2000/CE/II/47

With 1 unit of resources, country A can produce either _____ unit(s) of X or _____ unit (s) of Y while country B can produce either _____ unit(s) of X or _____ unit (s) of Y.

- A. 1 1/2 1/3 1/4
- B. 1 2 3 4
- C. 1 1/2 1 3/4
- D. 2 1 3/4 1

2000/CE/II/48

Both countries will gain from trade if 1 unit of X can exchange for

- A. 0.5Y.
- B. 0.6Y.
- C. 0.75Y.
- D. 1Y.

2001/CE/11/42

The production cost of 1 unit of food in country X is 3 units of clothing. When country X trades with country Y, it can obtain 1 unit of clothing import by export 0.2 units of food.

What is country X's total gain from trade if it exports 10 units of food to country Y?

- A. 20 units of clothing
- B. 30 units of clothing minus 10 units of food
- C. 50 units of clothing
- D. 50 units of clothing minus 10 units of food

Questions 43 and 44 refer to the following table which shows the data about country A.

	Good X (Units)		Good Y (Units)
Total output with no international trade	40	and	60
Total output with specialization and international trade	0	and	110
Total consumption with international trade	50	and	80

2001/CE/11/43

After specialization, country A produces _____ units less of good X and _____ units more of good Y. Therefore the opportunity cost of producing 1 unit of good Y is _____ units of good X.

- A. 40 50 4/5
- B. 40 50 5/4
- C. 50 30 3/5
- D. 50 30 5/3

2001/CE/11/44

In trading, country A exports _____ units of good Y and imports _____ units of good X. Therefore the terms of trade is _____.

- A. 20 10 $1Y = 1/2X$
- B. 20 10 $1Y = 2X$
- C. 30 50 $1Y = 3/5X$
- D. 30 50 $1Y = 5/3X$

2002/CE/11/44

Suppose Mrs Wong, a sole proprietor of a garment factory, is the best cook in town, but she leaves all the cooking to her domestic helper at home. Which of the following would be correct?

- A. The domestic helper has a comparative advantage in cooking.
- B. Both Mrs Wong and the domestic helper provide a labour service and receive wages.
- C. Complex division of labour is illustrated in this case.
- D. Both Mrs Wong and the domestic helper are tertiary producers.

2002/CE/11/45

The following table shows the output of X and Y per unit of resources in countries A and B.

	Goods X (units)	OR	Goods Y (units)
Country A	1	OR	3
Country B	2	OR	4

Which of the following is/are the terms of trade under which trade between the two countries is mutually beneficial?

- A. $1X = 2Y$
- B. $1X = 3Y$
- C. $2X = 5Y$
- D. All of the above are correct.

2002/CE/11/47

Consider the trade between two countries X and Y, both of which produce garments and computers only. If country X has the comparative advantage in producing garments, then country X

- A. produces more garments per unit of resources than country Y.
- B. produces better quality garments than country Y.
- C. gives up a smaller amount of computers in order to produce a unit of garments than country Y.
- D. gains more from their trade than country Y.

Answer Questions 45 and 46 by referring to the following table.

Before trade, the actual output of Country A and Country B with all their resources evenly allocated between the production of Good X and Good Y are shown below:

	Good X (Units)	AND	Good Y (Units)
Country A	100	AND	250
Country B	100	AND	50

2003/CE/11/45

Which of the following about the two countries is correct?

- A. Country B has a comparative advantage in producing Good Y.
- B. Country A can produce the same amount of Good Y with fewer resources.
- C. Trade between the two countries would not be mutually beneficial if the transportation cost of trading 1 unit of Good X is 2 units of Good Y.
- D. Country A would have a larger gain than Country B from each unit of Good X traded.

2003/CE/11/46

Suppose each country has to pay a transportation cost of 0.5 units of Good X in trading 1 unit of Good Y. Which one of the following terms of trade is mutually beneficial?

- A. $1Y = 0.5X$
- B. $1Y = 1X$
- C. $1Y = 1.5X$
- D. $1Y = 2X$

2004/CE/11/45

Both countries A and B produce goods X and Y. Under which of the following conditions does country A have a comparative advantage in the production of X?

- A. One unit of X can be exchanged for more units of Y in country A than in country B.
- B. In producing one unit of X, country A forgoes a smaller amount of Y than country B.
- C. The opportunity cost of producing X in country A is smaller than that of Y in country B.
- D. The amount of resources used in producing one unit of X is less in country A than in country B.

Refer to the information below and answer questions 46 and 47.

Both country A and country B produce rice and wine. Suppose country A has **ONE** unit of resources while country B has **TWO** units of resources. Each country allocates half of their resources in the production of each product. The amounts of output in country A and country B are shown below.

	Rice (Units)	AND	Wine (Units)
Country A	6		9
Country B	10		8

2004/CE/II/46

With **ONE** unit of resources,

- (1) country A can produce either 6 units of rice or 9 units of wine.
- (2) country A can produce either 12 units of rice or 18 units of wine.
- (3) country B can produce either 5 units of rice or 4 units of wine.
- (4) country B can produce either 10 units of rice or 8 units of wine.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

2004/CE/II/47

Which of the following statements is correct?

- A. According to the principle of comparative advantage, country A will import wine.
- B. According to the principle of comparative advantage, country B will import rice.
- C. Country A has an absolute advantage in the production of wine.
- D. Country B has an absolute advantage in the production of rice.

Answer Questions 45 and 46 with reference to the following table.

The following table shows the number of man-hours required by Country A and Country B in the production of toys and watches.

	1 unit of Toys	1 unit of Watches
Country A	1 man-hour	3 man-hours
Country B	2 man-hours	4 man-hours

2005/CE/II/45

Which of the following descriptions are correct?

- (1) Country A enjoys an absolute advantage in the production of both goods.
- (2) Country A enjoys an absolute advantage only in the production of toys.
- (3) Country B enjoys a comparative advantage in the production of toys.
- (4) Country B enjoys a comparative advantage in the production of watches.

- A. (1) and (3) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

2005/CE/II/46

According to the principle of comparative advantage, when the two countries trade with each other, Country A will export _____ and import _____, and a mutually beneficial terms of trade can be 1 unit of toys equals _____.

- A. toys watches 0.4 units of watches
- B. toys watches 2.5 units of watches
- C. watches toys 0.4 units of watches
- D. watches toys 2.5 units of watches

2006/CE/II/43

Under free trade, a country exports computers and imports cars. Which of the following statements about the country must be correct?

The country

- A. has an absolute advantage in producing cars.
- B. has an absolute advantage in producing computers.
- C. has a comparative disadvantage in producing cars.
- D. requires less resources to produce each unit of computers.

2006/CE/II/44

The output of DVDs and MP3 players per unit of input of Countries A and B are shown below respectively.

	DVD (units)	OR	MP3 Player (units)
Country A	10		30
Country B	8		12

If both countries have 3 units of inputs and complete specialization takes place according to the principle of comparative advantage, the total output of the two countries is _____ units of DVD and _____ units of MP3 player.

- A. 24 36
- B. 24 90
- C. 30 36
- D. 30 90

2006/CE/II/46

If Country X is more productive in producing every good than Country Y, then

- A. the two countries may still trade with each other.
- B. the gain from trade of Country X will be greater than that of Country Y.
- C. Country X will have a lower opportunity cost in producing every good than Country Y.
- D. no trade will take place between the two countries.

2007/CE/II/44

By using one unit of resources, Country A can produce 10 units of good X or 5 units of good Y. We can then conclude that

- A. Country A has a comparative advantage in producing good X.
- B. Country A has a comparative advantage in producing good Y.
- C. Country A may benefit from exporting good X if the international exchange ratio is $1X = 1Y$.
- D. Country A may benefit from exporting good Y if the international exchange ratio is $1X = 1Y$.

2007/CE/II/45

Which of the following statements about international trade is correct if transportation cost increases?

- A. The price of exported goods will increase if the exporting country has to bear the transportation costs.
- B. The net gains from trade of the trading partners will remain unchanged as long as trade continues.
- C. Comparative advantages will disappear if the transportation costs are higher than the total gains from trade.
- D. Mutually beneficial trade is possible only if the transportation costs are lower than the total gains from trade.

2007/CE/11/46

The table below shows the amount of resources required to produce good X and good Y by Country A and Country B respectively.

	1 unit of good X	1 unit of good Y
Country A	20 units	25 units
Country B	10 units	25 units

Which of the following can be a mutually beneficial terms of trade?

- A. $1X = 0.4Y$
- B. $1X = 0.5Y$
- C. $1X = 0.8Y$
- D. $1X = 0.9Y$

2008/CE/11/45

Suppose there are two countries A and B. The following table shows the output per unit of resources in these two countries in a certain year:

	Goods X (units)	OR	Goods Y (units)
Country A	2		4
Country B	3		1

According to the above table, Country A has a comparative advantage in producing Good _____ because _____.

- A. Y with the same amount of resources, Country A can produce more Y than Country B
- B. Y Country A has a lower opportunity cost in producing 1 unit of Y than in producing 1 unit of X
- C. Y Country A's opportunity cost of producing 1 unit of Y is lower than that of Country B
- D. X Country A's opportunity cost of producing 1 unit of X is lower than that of Country B

2009/CE/11/46

The following table shows the amount of garments and shoes that country A and country B can produce with ALL of their resources.

	Garments (units)	OR	Shoes (units)
Country A	10		30
Country B	10		20

Which of the following statements are correct?

- (1) Country A has an absolute advantage in producing shoes.
 - (2) According to the principle of comparative advantage, country A will export shoes.
 - (3) Country B would gain from exporting garments if 1 unit of garments can be exchanged for more than 2 units of shoes.
- A. (1) and (2) only
 - B. (1) and (3) only
 - C. (2) and (3) only
 - D. (1), (2) and (3)

Answer questions 45 and 46 by referring to the following table. It shows the amount of toys and garments produced per unit of input of Country A and Country B.

	Garments (units)	OR	Toys (units)
Country A	10		40
Country B	5		10

2010/CE/11/45

Which one of the following statements is correct ?

- A. Country A gives up a smaller amount of garments than Country B in producing one unit of toys.
- B. The opportunity cost of producing garments in Country A is lower than that of Country B.
- C. Country A uses a larger amount of resources than Country B in producing one unit of garments.
- D. The total output of toys in Country A is higher than that of Country B.

2010/CE/11/46

When trade opens up between the two countries, 1 unit of toys can be exchanged for 0.4 units of garments. According to the principle of comparative advantage,

- A. Country A's gain from trade per unit of export is 0.15 units of garments.
- B. Country B's gain from trade per unit of export is 0.1 units of garments.
- C. Country A's gain from trade per unit of import is 2 units of toys.
- D. Country B's gain from trade per unit of import is 2 units of toys.

2010/CE/11/47

The table below shows the amount of labour input required to produce watches and oranges by Country X and Country Y respectively.

	Watches (units)	Oranges (units)
Country X	2 man-hours	2 man-hours
Country Y	4 man-hours	8 man-hours

Based on the above information, Country X has an absolute advantage and has a comparative advantage in producing watches.

- A. Country X Country X
- B. Country X Country Y
- C. Country Y Country X
- D. Country Y Country Y

2012/DSE/1/37

The following table shows the number of toys or clothes that Country A and Country B can produce with one unit of resources.

	Toys (units)	Clothes (units)
Country A	10	10
Country B	4	10

If the terms of trade is 2 units of clothes = 1 unit of toys,

- A. Country A will gain 5 units of toys per unit of imports.
- B. Country A will gain 0.6 units of clothes per unit of exports.
- C. Country B will gain 0.5 units of clothes per unit of imports.
- D. Country B will export toys and gain 0.6 units of clothes per unit of exports.

2012/DSE/I/38

Consider the trade of a good between two countries. Suppose we know their opportunity costs of producing the good. Without knowing the terms of trade, we can determine

- (1) the possible range of the terms of trade.
- (2) the gain of each country from trading one unit of the good.
- (3) the total gain of both countries from trading one unit of the good.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

Answer Questions 38 and 39 by referring to the following information.

Before trade, the output of Thailand and Japan with all their resources evenly allocated between the production of rice and computers is shown below:

	Rice (units)	AND	Computers (units)
Thailand	15	AND	5
Japan	24	AND	12

2013/DSE/I/38

Which of the following statements about the above case is correct?

- (1) Japan has a comparative advantage in producing computers.
- (2) Japan has an absolute advantage in producing computers.
- (3) With complete specialization in the two countries, the total output of both rice and computers will increase.

- A. (1) only
- B. (1) and (2) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2013/DSE/I/39

Suppose the terms of trade is 1 unit of computers = 2.4 units of rice and the computer-exporting country has to pay a transportation cost of 0.1 units of rice for each unit of export. To export 5 units of computers, the net gain of the country is _____ units of rice.

- A. 1.5
- B. 2
- C. 2.5
- D. 3

2014/DSE/I/41

The following table shows the number of man-hours required by Country A and Country B in the production of Good X and Good Y.

	1 unit of Good X	1 unit of Good Y
Country A	10 units	25 units
Country B	5 units	15 units

Trade is mutually beneficial between Country A and Country B when the terms of trade is _____.

- A. $1X = 0.35Y$
- B. $1X = 0.4Y$
- C. $1X = 1.25Y$
- D. $1X = 2.75Y$

2014/DSE/I/44

The following table shows the data about Country A.

	Petroleum (unit)	and	Rubber (unit)
Total output with no international trade	60	and	90
Total output with specialization and international trade	0	and	210
Total consumption with international trade	90	and	120

Which of the following statements about Country A is correct?

- A. Country A has both absolute advantage and comparative advantage in producing rubber.
- B. The gain from trade of exporting 1 unit of rubber is 1 unit of petroleum.
- C. The opportunity cost of producing 1 unit of rubber (R) is $2/3$ units of petroleum (P) and the terms of trade is $1R = 3/4P$.
- D. Country A can benefit from trading with Country B, whose opportunity cost of producing 1 unit of rubber is 2 units of petroleum.

2015/DSE/I/40

Assume the labour input requirements for the production of computers and toys in Japan and Hong Kong are as follows:

	1 unit of computers	1 unit of toys
Japan	2 man-hours	6 man-hours
Hong Kong	4 man-hours	8 man-hours

Suppose there is no transportation cost. Which of the following can be the terms of trade so that trade is mutually beneficial to Japan and Hong Kong?

- A. 1 unit of computers exchanges for 0.4 units of toys
- B. 1 unit of computers exchanges for 0.5 units of toys
- C. 1 unit of computers exchanges for 1 unit of toys
- D. 1 unit of computers exchanges for 2.5 units of toys

2015/DSE/I/41

A country has an absolute advantage in producing good X. Which of the following statements about the country is correct?

- A. The country can produce a greater amount of good X than another good with the same amount of resources.
- B. The country has a comparative advantage in producing good X.
- C. The country has an absolute disadvantage in producing another good.
- D. The country may import good X from the international market.

2016/DSE/I/41

The following table shows the amount of toys or cars that Country A and Country B can produce with the same amount of resources.

	Toys	or	Cars
Country A	50	or	80
Country B	20	or	60

The transportation cost for 1 unit of toy is 0.4 units of car and it is borne by the importing country. Which of the following is the mutually beneficial terms of trade between Country A and Country B?

- A. 1 unit of toy = 1.6 units of car
- B. 1 unit of toy = 2 units of car
- C. 1 unit of toy = 2.6 units of car
- D. 1 unit of toy = 3 units of car

2017/DSE/1/43

The following table shows the number of man-hours required by Country A and Country B in the production of toys and watches.

	1 unit of toys	1 unit of watches
Country A	4	8
Country B	5	20

Suppose the transportation cost for 1 unit of toys is 0.1 units of watches and it is borne by the exporting country. Which of the following would be a mutually beneficial terms of trade between Country A and Country B?

- A. 1 unit of toys = 0.3 units of watches
- B. 1 unit of toys = 0.4 units of watches
- C. 1 unit of toys = 2.5 units of watches
- D. 1 unit of toys = 6 units of watches

2018/DSE/1/43

The following table shows the output per unit of resources in Countries A and B:

	Computer (units)	OR	Rice (units)
Country A	16		16
Country B	12		3

Suppose the computer-producing country exports 10 units of computer in exchange for 5 units of rice. What is the total gain from trade for computer-importing country?

- A. 0.5 units of computer
- B. 1 unit of computer
- C. 2.5 units of computer
- D. 5 units of computer

1992/AL/11/17

Refer to the following table which shows the costs of production of two goods in two countries:

	TV Sets	Cars
Japan	¥80	¥160
USA	\$10	\$30

Which of the following are true?

- (1) Japan has a comparative advantage in the production of cars.
- (2) A terms of trade ratio of 1 Car = 2.5 TV sets would make the trade between the two countries mutually beneficial.
- (3) U.S.A. has an absolute advantage in the production of TV sets.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

1996/AL/11/25

The unit cost of producing cars and computers in the U.K. and Country A are given below:

	Cars	Computers
U.K.	£280	£70
Country A	\$450	\$150

Which of the following statement(s) is/are correct?

- (1) Country A has a comparative advantage in producing cars.
- (2) U.K. has an absolute advantage in producing both goods.
- (3) U.K. has a comparative disadvantage in producing cars and an absolute advantage in producing computers.

- A. (1) only
- B. (1) and (2) only
- C. (2) and (3) only
- D. (1), (2) and (3)

1997/AL/11/15

The unit cost of production of garments and Discmans in Hong Kong and Japan are as follows:

	Garments	Discmans
Hong Kong	\$200	\$2 000
Japan	¥10 000	¥50 000

Which of the following are true?

- (1) Hong Kong has a comparative advantage in producing garments.
- (2) If the terms of trade are that 1 unit of Discmans can be exchanged for 7 units of garments, then trade is mutually beneficial to both economies.
- (3) If the terms of trade are that 1 unit of Discmans can be exchanged for 9 units of garments, then the gain to Japan from exporting 1 unit of Discmans is 4 units garments.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

The following table shows the amount of goods that can be produced with 1 unit of resources in Country A and Country B respectively.

	Good X (units)	or	Good Y (units)
Country A	8		12
Country B	2		4

Suppose the transportation cost for 1 unit of Good X is 0.2 units of Good Y and it is borne by the exporting country. Which of the following is a mutually beneficial terms of trade between Country A and Country B?

- A. 1 unit of Good X = 1.3 units of Good Y
- B. 1 unit of Good X = 1.7 units of Good Y
- C. 1 unit of Good X = 1.8 units of Good Y
- D. 1 unit of Good X = 2.0 units of Good Y

2020/DSE/I/42

The following table shows the amounts of consumption on two goods in Country A and Country B before international trade. Assume both countries use one unit of resources on producing Good X and one unit of resources on producing Good Y.

	Consumption before trade (units)	
	Good X	Good Y
Country A	100	and 25
Country B	80	and 40

If Country A and Country B completely specialise their production and trade with each other, the total output of both countries will increase by _____ units of Good X and _____ units of Good Y.

- A. 15 15
- B. 15 20
- C. 20 15
- D. 20 20

2021/DSE/I/43

Both Country A and Country B produce only toys and computers. The table below shows the amount of inputs required by Country A and Country B in the production of toys and computers.

	1 unit of toys	1 unit of computers
Country A	2	5
Country B	2	2

Based on the above information, which of the following statements is correct?

- A. Country A has an absolute advantage in the production of computers over Country B.
- B. Country B has no comparative advantage in producing any goods as its opportunity cost of producing toys equals that of producing computers.
- C. If a transportation cost of 1 unit of computers is required to trade 1 unit of toys, it is impossible to have mutually beneficial trade.
- D. It is impossible to have mutually beneficial trade as the two countries have equal productivity in producing toys.

Short & Structured Questions

1991/CE/I/3/(c)

Suppose there are only two countries and two commodities in the world. Every year each has 20 units of resources. Each uses 10 units of resources per year to produce each commodity. The annual output per unit of resources is shown below:

	Food (units)	OR	Clothing (units)
Country A	6		12
Country B	5		20

- (i) Which country has a comparative advantage in producing food? Explain your answer. (7 marks)
- (ii) Calculate the increase in the total output per year of each commodity after complete specialization, based on the principle of comparative advantage. (4 marks)
- (iii) What piece of information is needed to determine the distribution of the increase in outputs between these two countries? (2 marks)

1992/CE/I/2/(a)

The following table shows the output per unit of resources in two countries in a certain year:

	Clothing (units)	OR	Rice (units)
Country A	1		2
Country B	3		4

- (ii) According to the principle of comparative advantage, which product should Country A specialize in? Explain your answer in terms of opportunity cost. (6 marks)
- (iii) Explain how trade is beneficial to Country A if 10 units of clothing are exchanged for 18 units of rice. (4 marks)
- (iv) Suppose the productivity in Country A has increased. With one unit of resources, Country A can now produce 2 units of clothing or 4 units of rice. Will your answer in (a)(ii) change? Explain. (4 marks)

1993/CE/I/2/(a)

Suppose the annual output per unit of resources in the U.S.A. and China are as follows:

	Clothing(Units)	OR	Toys(Units)
U.S.A.	2		4
China	1		2

- (i) In the U.S.A., what is the opportunity cost of producing one unit of clothing? One unit of toys? (2 marks)
Based on the above answers only, explain whether you can say that the U.S.A. has a comparative advantage over China in toy manufacturing. (3 marks)
- (ii) State the principle of comparative advantage. According to this principle, explain whether specialization and trade can benefit the above two countries. (6 marks)
- (iii) Suppose with one unit of resources, China can now produce 2 units of clothing or 3 units of toys. Explain whether specialization and trade can benefit the above two countries. (5 marks)

1994/CE/1/9/(c)

Suppose the production of cars and apples in Japan and in the U.S.A. is as follows:

	One Unit of Resources Can Produce	
	Cars (Units)	Apples (Units)
Japan	2	5
U.S.A.	1	4

Suppose there are no trade barriers between the two countries. When trade opens up, 3 units of apples are traded for 1 unit of cars. Find the comparative advantage of **EACH** country and calculate the gain of **EACH** country from one unit of exports. Explain your answer. (9 marks)

1995/CE/1/8

The following table shows the production of goods X and Y per unit of resources in Countries A and B

Country	Good X (units)	OR	Good Y (units)
A	1	OR	4
B	2	OR	3

- (a) According to an economic principle, both countries would gain from specialization and trade. Name and state this principle. (4 marks)
- (b) Calculate the range of the exchange ratio between goods X and Y for both countries to gain from trade. (4 marks)

1996/CE/1/10(a)

The table below shows the output per unit of resources of two countries in a certain year

	Clothing (units)	OR	Rice (units)
Country A	2	OR	6
Country B	6	OR	9

- (i) Explain which country would have a comparative advantage in producing clothing. Show your calculation. (3 marks)
- (ii) Suppose 1 unit of clothing can be exchanged for 2 units of rice between the two countries. Calculate and explain how much Country A would gain from trade if
- (I) no other costs are involved in trade. (3 marks)
- (II) Country A has to pay a transportation cost of 1 unit of rice per unit of import. (3 marks)

1997/CE/1/10(a)

With one unit of resources, the output of food and clothing in Country A and Country B is as follows:

	Food (units)	OR	Clothing (units)
Country A	4	OR	8
Country B	3	OR	6

- (i) Explain whether there are mutually beneficial terms of trade between these two countries. (3 marks)
- (ii) Suppose only Country A benefits from technological advancement and it can now produce 5 units of food or 20 units of clothing with one unit of resources.
- (I) Explain which country has a comparative advantage in producing food. (3 marks)
- (II) If the exchange ratio between the two countries is 1 unit of food for 3 units of clothing, calculate the gain of Country B per unit of export. (3 marks)

1998/CE/1/10(a)

Suppose the output per unit of resources of three economies – Hong Kong, Mainland China and Taiwan – are as follows:

	Toy (units)	OR	Computer (units)
Hong Kong	40	OR	4
Mainland China	50	OR	2
Taiwan	50	OR	10

- (i) Calculate the opportunity cost of producing computers for each economy and point out which economy has a comparative advantage in producing computers. (4 marks)
- (ii) Explain whether Hong Kong and Mainland China would gain from trade if 10 units of toy could be exchanged for 1 unit of computer. (6 marks)

1999/CE/1/9(a)

Suppose the output of red wine and cars in France and Japan per unit of resources are as follows:

	Red wine (units)	OR	Cars (units)
France	4	OR	2
Japan	1	OR	2

Suppose France and Japan trade at an exchange ratio of 3 units of red wine to 2 units of cars. Calculate the gain per unit of import for France. (6 marks)

2000/CE/1/11(a)

The following table shows the actual output of Country A and Country B. Each country employs 40% of resources to produce wine and the other 60% to produce clothing.

	Wine (units)	Clothing (units)
Country A	1 200	900
Country B	400	2 400

- (i) Calculate the opportunity cost of producing one unit of wine for **EACH** country and hence explain which country will export wine if they trade with each other. (6 marks)
- (ii) What is the minimum transportation cost per unit of wine (expressed in terms of clothing) which will result in both countries **NOT** gaining from trade? Explain your answer. (4 marks)

2001/CE/1/9(a)

Suppose the output of garments and computers per unit of resources of the two economies, Hong Kong and the USA, are as follows:

	Garments (units)	OR	Computers (units)
Hong Kong	4	OR	2
USA	4	OR	5

- (i) Calculate the opportunity cost of producing one unit of garments for **EACH** economy. Explain which economy would export garments. (4 marks)
- (ii) Suppose the exporting economy has to pay a transportation cost of 0.5 units of computers to export 1 unit of garments. Find the possible range of terms of trade (for 1 unit of garments) that is mutually beneficial for both economies. (3 marks)

2002/CE/1/9

The following table shows the maximum amount of toys and computers that Country A and Country B can produce in a year with ALL of their resources respectively.

	Toys (Units)	OR	Computers (Units)
Country A	15	OR	5
Country B	10	OR	5

Explain whether we can conclude from the above table that Country A has

- (a) an absolute advantage
(b) a comparative advantage

in producing toys.

(7 marks)

2003/CE/1/10(c)

Suppose the output of paper and cars per unit of resources of Country A and Country B are as follows:

	Paper (units)	OR	Cars (units)
Country A	10	OR	10
Country B	15	OR	30

- (i) Explain which country has a comparative advantage in the production of paper. Calculate the total gain to the two countries from trading one unit of paper. (5 marks)
- (ii) Suppose a newly developed Country, X, now offers paper for sale with an exchange ratio of 1 unit of paper to 0.5 units of cars. Explain whether Country B would import paper from Country A. (3 marks)

2004/CE/1/11(a)

Suppose the amount of resources of Economy A is double that of Hong Kong and both economies use ALL their resources in production. Their maximum output in a year is shown below.

	Clothing (units)	OR	Cars (units)
Economy A	20	OR	10
Hong Kong	12	OR	3

- (i) Explain whether Economy A has an absolute advantage in producing clothing. (3 marks)
- (ii) Explain in which product Economy A has a comparative advantage. Calculate the gain per unit of export for Economy A if the two economies trade at an exchange ratio of 5 units of clothing to 2 units of cars. (6 marks)

2005/CE/1/10

With the same amount of resources, the output of watches and television sets in Country A and Country B are as follows:

Country	Watches (Units)	OR	TV sets (Units)
A	10	OR	5
B	20	OR	15

- (a) (i) Explain which country enjoys the absolute advantage in the production of television sets. (2 marks)
- (ii) The two countries have a different output of watches, with each country using the same amount of resources in their production. State **THREE** possible reasons for such a difference. (3 marks)
- (b) (i) State the principle of comparative advantage. According to this principle, explain which country would export watches. (5 marks)
- (ii) (I) Point out the range of terms of trade (for 1 unit of watches) that is mutually beneficial for both countries. (2 marks)
- (II) Explain why a terms of trade outside the above range would not be mutually beneficial for both countries. (4 marks)

2006/CE/1/8

Suppose the output of clothing and computers per unit of resources of Country A and Country B are as follows:

	Clothing (units)	OR	Computers (units)
Country A	100	OR	200
Country B	150	OR	450

- (a) Explain which country enjoys a comparative advantage in the production of clothing. (3 marks)
- (b) Suppose 1 unit of clothing is traded for 2.5 units of computers between the two countries. Calculate Country A's gain from trade per unit of export. (2 marks)

2007/CE/1/10(b)

Assume the output of vegetables and jewels of one unit of resources in two cities are as follows respectively:

	Vegetables (unit)	OR	Jewels (unit)
Hong Kong	5	OR	1
Shenzhen	12	OR	1

- (i) Suppose the terms of trade between the two cities is 1 unit of jewels = 10 units of vegetables. Calculate the gain for Hong Kong per unit of her exports. (3 marks)
- (ii) Suppose 1 unit of resources in Shenzhen can only grow 9 units of vegetables due to flooding after the typhoon. What is the range of the new terms of trade that is mutually beneficial to both cities? (3 marks)

2008/CE/1/7

The amount of resources of Country A is half that of Country B. Both countries use **ALL** their resources in production. Their maximum output in a year is shown below.

	Food (units)	OR	Machines (units)
Country A	20	OR	50
Country B	40	OR	60

Explain, respectively, whether Country B has an/a

- (a) absolute advantage
(b) comparative advantage

in producing food.

(7 marks)

2009/CE/1/10(b)

Suppose the following table show the outputs of mainland China and Taiwan per unit of resources.

	Computers (units)	OR	Toys (units)
Mainland China	50	OR	90
Taiwan	200	OR	250

- (i) Explain which economy would have a comparative advantage in producing computers. (4 marks)
(ii) Suppose 1 unit of computers can be exchanged for 1.5 units of toys when trade opens up between the two economies.

If the computer exporting economy has to pay a transportation cost of 0.2 units of toys for each unit of export, calculate and explain how much it would gain from exporting 1 unit of computers. (3 marks)

2010/CE/1/10(b)

Suppose the following table shows the outputs of Hong Kong and Japan per unit of resources.

	Medicine (units)	OR	Watches (units)
Hong Kong	40	OR	100
Japan	20	OR	40

- (i) State the principle of comparative advantage. (2 marks)
(ii) According to the principle of comparative advantage, find the range of terms of trade (for 1 unit of medicine) that is mutually beneficial for both economies. (4 marks)

2012/DSE/11/9

Country A requires 2 working-hours to produce a unit of shirts while Country B requires 1 working-hour. On the other hand, Country A requires 10 working-hours to produce a unit of watches while Country B requires 4 working-hours.

Suppose labour is the only resource required for the production of shirts and watches.

- (a) Calculate the opportunity costs of producing 1 unit of shirts (in terms of watches) for Country A and Country B. (2 marks)
(b) State the principle of comparative advantage. According to this principle, explain which country would export shirts. (3 marks)
(c) Find the range of terms of trade over which exchange between both countries is mutually beneficial. (2 marks)

2013/DSE/11/5

Each unit of resources can be used to produce the following amount of goods in Country A and Country B:

	Food (units)	OR	Smartphones (units)
Country A	30	OR	40
Country B	40	OR	80

- (a) Explain which country has a comparative advantage in the production of smartphones. (3 marks)
(b) Suppose the transportation cost per unit of smartphones traded is 0.2 units of food. Is it possible to have mutually beneficial trade between these two countries? Explain. (3 marks)

2014/DSE/11/8

Suppose the output of paper and watches per unit of resources of Country A and Country B are as follows:

	Paper (unit)	OR	Watches (unit)
Country A	12	OR	3
Country B	8	OR	4

- (a) Which good would Country B export according to its comparative advantage? Explain. (3 marks)
(b) Suppose Country A and Country B trade at an exchange ratio of 2 units of watches to 5 units of paper. Calculate the gain per unit of import for Country A. (3 marks)

2015/DSE/11/7

Suppose both Country A and Country B use **ALL** their resources in production. Their maximum output is shown in the table below.

	Rice (units)	OR	Clothing (units)
Country A	15	OR	3
Country B	8	OR	4

- (a) Explain whether Country B has an absolute advantage in producing clothing. (2 marks)
(b) The rice-exporting country exports 12 units of rice in exchange for 3 units of clothing. Calculate the total gain from trade for the clothing-exporting country. Show your workings. (4 marks)

2016/DSE/11/7

The input requirements in the production of one unit of clothing and one unit of toys are 6 units and 2 units respectively in Country A. Country A and Country B trade at an exchange ratio of 2 units of clothing to 11 units of toys.

- (a) Which good would Country A export? Explain. (3 marks)
(b) Suppose a transportation cost of 2 units of toys is required to exchange for 1 unit of clothing and the cost is borne by Country A. Calculate the gain per unit of export for Country A. (3 marks)

2017/DSE/II/7

Country A and Country B both allocate half of their resources in producing food and half in producing computers. Their total output is shown below.

	Food (units)	Computer (units)
Country A	100	50
Country B	100	100

- (a) Explain whether Country B
- enjoys an absolute advantage in producing computers.
 - will export computers. (5 marks)
- (b) Suppose the exchange ratio is 4 units of computer for 7 units of food. Calculate the gain from trade for the computer-exporting country when it exports 16 units of computer. Show your working. (3 marks)

2018/DSE/II/8

Suppose the labour requirement for the production of toys and clothing in China and Japan is as follows:

	1 unit of toys	1 unit of clothing
China	10 man-hours	2 man-hours
Japan	8 man-hours	4 man-hours

- (a) Calculate the opportunity costs of producing one unit of toys for China and Japan respectively. (2 marks)
- (b) State the principle of comparative advantage. According to this principle, explain which country would export toys. (3 marks)
- (c) Suppose the transportation cost per unit of toys traded is 0.1 units of clothing and has to be shared equally by both countries. Find the range of terms of trade over which exchange between both countries is mutually beneficial. (2 marks)

2019/DSE/II/8

The amount of resources in Country A is twice of that in Country B. Both countries allocate half of their resources to produce cars and the other half to produce toys. The following are the total outputs of both countries:

	Cars (units)	Toys (units)
Country A	100	100
Country B	100	60

- (a) Explain whether Country B has
- an absolute advantage in producing cars.
 - a comparative advantage in producing cars. (5 marks)
- (b) Suppose the exchange ratio is 5 units of cars for 4 units of toys. Calculate the gain from trade for the car-importing country when it imports 10 units of cars. Show your workings. (3 marks)

2020/DSE/II/7

Suppose the outputs per unit of resources of Country A and Country B are as follows:

	Toys (units)	OR	Cars (units)
Country A	10	OR	10
Country B	20	OR	10

- (a) Which good would Country B export according to its comparative advantage? Explain. (3 marks)
- (b) Suppose Country A and Country B trade at an exchange ratio of 5 units of toys to 4 units of cars. A transportation cost of 0.2 units of cars is required to exchange for 1 unit of toys and the cost is equally shared by both countries. Calculate the gain per unit of export of Country B. Show your workings. (3 marks)

2021/DSE/II/8

Suppose the outputs per unit of resources of Country A and Country B are as follows.

	Rice (units)	OR	Wheat (units)
Country A	10	OR	4
Country B	6	OR	3

Find the range of terms of trade over which exchange between these two countries is mutually beneficial. Show your workings. (3 marks)

MARKING SCHEME

1990/CE/11/42 A	1996/CE/11/53 B	2001/CE/11/44 D	2006/CE/11/44 B (65%)	2013/DSE/1/38 A (50%)
1990/CE/11/48 D	1997/CE/11/53 B	2002/CE/11/44 A (44%)	2006/CE/11/46 A (54%)	2013/DSE/1/39 A (64%)
1991/CE/11/53 A	1998/CE/11/43 B	2002/CE/11/45 C (44%)	2007/CE/11/44 C (67%)	2014/DSE/1/41 A (59%)
1992/CE/11/51 A	1998/CE/11/44 A	2002/CE/11/47 C (69%)	2007/CE/11/45 D (51%)	2014/DSE/1/44 D (39%)
1992/CE/11/53 C	1998/CE/11/45 B	2003/CE/11/45 C (31%)	2007/CE/11/46 B (62%)	2015/DSE/1/40 A (66%)
1993/CE/11/52 A	1999/CE/11/46 A	2003/CE/11/46 B (24%)	2008/CE/11/45 C (65%)	2015/DSE/1/41 D (45%)
1994/CE/11/52 A	1999/CE/11/48 D	2004/CE/11/45 B (50%)	2009/CE/11/46 C (43)	2016/DSE/1/41 B (60%)
1994/CE/11/53 C	2000/CE/11/46 D	2004/CE/11/46 D (40%)	2010/CE/11/45 A (61)	2017/DSE/1/43 B (65%)
1995/CE/11/51 B	2000/CE/11/47 A	2004/CE/11/47 C (65%)	2010/CE/11/46 A (64)	2018/DSE/1/43 D (38%)
1995/CE/11/52 D	2000/CE/11/48 B	2005/CE/11/45 B (47%)	2010/CE/11/47 B (51)	1992/AL/11/17 A
1996/CE/11/46 D	2001/CE/11/42 A	2005/CE/11/46 A (47%)	2012/DSE/1/37 D (65%)	1996/AL/11/25 A
1996/CE/11/47 D	2001/CE/11/43 A	2006/CE/11/43 C (43%)	2012/DSE/1/38 B (47%)	1997/AL/11/15 D
2019/DSE/1/42 C	2020/DSE/1/42 C	2021/DSE/1/43 C		

1991/CE/1/3(c)

- (i) The opportunity cost of producing 1 unit of food
in Country A: $12 \div 6 = 2$ units of clothing (2)
in Country B: $20 \div 5 = 4$ units of clothing (2)
- Country A has a comparative advantage over Country B in food production because
A produces food at a relatively lower opportunity cost than B. (3)
- (ii) Increase in food = $(6 \text{ units} \times 20) - [(6 \text{ units} \times 10) + (5 \text{ units} \times 10)]$ (1)
= 10 units (1)
Increase in clothing = $(20 \text{ units} \times 20) - [(12 \text{ units} \times 10) + (20 \text{ units} \times 10)]$ (1)
= 80 units (1)
- (iii) Terms of trade / exchange ratio of trading the two commodities (2)

1992/CE/1/2(a)

- (ii) The opportunity cost of producing 1 unit of rice
in Country A is 0.5 units of clothing whereas that (2)
in Country B is 0.75 units of clothing (2)
- Country A produces rice at a lower opportunity cost than Country B (1)
 \therefore Country A should specialize in rice production (1)
- (iii) The opportunity cost of Country A in producing 18 (= 2×9) of rice is 9 (= 1×9) units of clothing (2)
 \Rightarrow Country A gains 1 unit of clothing from every 18 units of rice sold to Country B (2)
- OR**
- The opportunity cost of Country A in producing 10 (= 1×10) units of clothing is 20 (= 2×10) units of rice (2)
 \Rightarrow Country A saves up 2 units of rice when it buys 10 units of clothing from Country B (2)
- (iv) No, because (1)
the outputs of Country A are doubled but the opportunity cost of producing rice remains the same as in (a)(ii) above (3)
(i.e. 1 unit of rice is exchanged for 0.5 units of clothing)

1993/CE/1/2(a)

- (i) The opportunity cost of one unit of clothing is 2 units of toys, (1)
while that for toys is 1/2 units of clothing. (1)
- No, we can't, because (1)
to find out the comparative advantage, one has to compare the opportunity cost of toy production in the U.S.A with
that in China (and see which cost is lower). (3)
- (ii) The principle of comparative advantage: if each country specializes in producing the good in which it has a lower
opportunity cost, then the total output will increase. (3)
The opportunity cost of producing clothing (or toys) in China is the same as that in the U.S.A., i.e. 1 unit of clothing is
exchanged for 2 units of toys. (2)
 \Rightarrow there is no gain from specialization and trade (1)
- (iii) The new opportunity cost of producing one unit of clothing in China is 3/2 units of toys which is smaller than that (2)
units in the U.S.A. (2)
 \Rightarrow China should specialize in producing clothing and the U.S.A. should specialize in producing toys. Trade between
the two countries can benefit both. (3)

1994/CE/1/9(c)

- Comparative advantage
- Unit cost of car production in Japan in terms of apples = $5/2 (= 2.5)$ units (1)
Unit cost of car production in the U.S.A. in terms of apples = $4/1 = 4$ units (1)
 \therefore Japan has a comparative advantage in producing cars. Conversely, the U.S.A. has a comparative advantage in growing
apples. (1)
- OR**
- Unit cost of apples growing in Japan in terms of cars = $2/5 (= 0.4)$ units (1)
Unit cost of apples growing in U.S.A. in terms of cars = $1/4 (= 0.25)$ units (1)
 \therefore The U.S.A. has a comparative advantage in growing apples. Conversely, Japan has a comparative advantage in
producing cars (1)
- | | | |
|--------------------------------------|---|-----|
| <u>Gain from trade: Japan</u> | <u>Units of apples obtained from 1 unit of cars</u> | |
| Before specialization (within Japan) | 2.5 units of apples | (1) |
| After specialization and trade | 3 units of apples | (1) |
| Gain | $(3 - 2.5) = 0.5$ units of apples | (1) |
-
- | | | |
|--|---|-----|
| <u>Gain from trade: U.S.A.</u> | <u>Units of cars obtained from 1 unit of apples</u> | |
| Before specialization (within the USA) | 0.25 units of cars | (1) |
| After specialization and trade | 0.3333 units of cars | (1) |
| Gain | $(0.3333 - 0.25) = 0.0833$ units of cars | (1) |

1995/CE/1/8

- (a) The principle of comparative advantage.
If each country specializes in producing the good in which it has a lower opportunity cost, then the total output will increase. (1)
(3)
- (b) $1.5Y < 1X < 4Y$
OR
 $0.25X < 1Y < 0.66X$ (4)

1996/CE/1/10(a)

- (i) Within A, the production cost of 1 unit of clothing is 3 units of rice. (1)
Within B, the production cost of 1 unit of clothing is 3/2 units of rice. (1)
∴ B has a lower cost or a comparative advantage over A in the production of clothing. (1)
- (ii) (I) Under no trade, the unit price of clothing in A is 3 units of rice forgone. When A trades with B, the import price of 1 unit of clothing is 2 units of rice exported to B.
∴ A can save 1 unit of rice per unit of clothing imported from B.
OR
Similarly, the unit price of rice in A before trade is 1/3 units of clothing. With trade, the export price of 1 unit of rice is 1/2 units of clothing imported.
∴ A can gain 1/6 units of clothing from exporting 1 unit of rice. (3)
- (II) Including the transport cost, the (total) cost of 1 unit of clothing imported from B is 3 units of rice. This equals to the unit cost of production of clothing in A.
∴ there is no gain for A to trade with B. (3)

1997/CE/1/10(a)

- (i) Same exchange ratio of food and clothing before trade, which is 1 unit of food (F) for 2 units of clothing (C) / same opportunity cost in both countries: $1F = 2C$ (1)
∴ no such terms of trade (1)
- (ii) (I) In Country A, the cost of 1 unit of food is (20/5 = 4) units of clothing. (1)
∴ In comparison,
[either by showing the cost of 1 unit of food in Country B is 2 units of clothing or explicitly shown in (a)(i)]
Country B has a lower opportunity cost in producing food. (1)
∴ Country B has the comparative advantage in food production. (1)

(II)

	Food (units)	Clothing (units)
after trade	-1	+3
before trade	-1	+2
gain from trade		+1

∴ 1 unit of clothing is gained. / 0.5 units of food is saved. (1)

1998/CE/1/10(a)

- (i) The opportunity cost of producing 1 unit of computer in
Hong Kong is 10 units of toy (1)
Mainland China is 25 units of toy (1)
Taiwan is 5 units of toy (1)
Taiwan has the comparative advantage in producing computers (because her opportunity cost is the lowest among the three economies). (1)
- (ii) HK's opportunity cost (1C = 10T, C = clothing, T = toy) is the same as the international price (1C = 10T) (2)
∴ HK will not gain (1)
- Mainland China's opportunity cost of producing toys (cost of producing 1T = 0.04C) is lower than her export price of toys (1T = 0.1C) (2)
OR
Mainland China's opportunity cost of producing computers (cost of producing 1C = 25T) is higher than her import price of computers (1C = 10T) (1)
∴ Mainland China will gain. (1)

1999/CE/1/9(a)

- France's opportunity cost of producing one unit of cars is 2 (= 4/2) units of red wine. (1)
Japan's opportunity cost of producing one unit of cars is 1/2 units of red wine.
OR
France's import price of one unit of cars is 1.5 (= 3/2) units of red wine. (1)
∴ France should import cars from Japan. (1)
- France's gain = 2 units of red wine - 1.5 units of red wine = 0.5 units of red wine (3)

2000/CE/1/11(a)

- (i) Country A can produce (1 200 ÷ 0.4) units of wine or (900 ÷ 0.6) units of clothing.
∴ A's opportunity cost of wine production is (900 ÷ 0.6) / (1 200 ÷ 0.4) = 0.5 units of clothing. (2)
Country B can produce (400 ÷ 0.4) units of wine or (2 400 ÷ 0.6) units of clothing.
∴ B's opportunity cost of wine production is (2 400 ÷ 0.6) / (400 ÷ 0.4) = 4 units of clothing. (2)
- A has a lower opportunity cost / comparative advantage in wine production. (1)
⇒ A exports wine. (1)
- (ii) No country will gain when the transportation cost per unit of wine ≥ total gain of trade per unit of wine / difference in the two domestic opportunity costs. (2)
∴ min. transportation cost = [4 - 0.5] = 3.5 units of clothing (2)

2001/CE/1/9(a)

- (i) The opportunity cost of producing 1 unit of garments
Hong Kong: 2 ÷ 4 = 0.5 units of computers (1)
USA: 5 ÷ 4 = 1.25 units of computers (1)
Hong Kong has a lower opportunity cost in producing garments / comparative advantage in garment production. (1)
∴ Hong Kong will export garments. (1)
- (ii) The range of T.O.T. with transportation is:
1 unit of computers < 1 unit of garments < 1.25 units of computers (3)

2002/CE/1/9

- (a) No, we cannot because the amount of resources of both countries are not given. (1)
(2)
- (b) Yes, we can because (1)
in Country A, the cost of 1 unit of toys is $5/15 = 1/3$ units of computers (1)
in Country B, the cost of 1 unit of toys is $5/10 = 1/2$ units of computers (1)
∴ Country A has a lower cost in producing toys. (1)

2003/CE/1/10(c)

- (i) The opportunity cost of producing 1 unit of paper
in Country A: $10 \div 10 = 1$ unit of cars (1)
in Country B: $30 \div 15 = 2$ units of cars (1)
Country A has a comparative advantage in producing paper, because its opportunity cost is lower. (1)
Total gain from trading 1 unit of paper for Countries A and B is $[2 - 1 =] 1$ unit of cars (1)
- (ii) No, because (1)
(given that the opportunity cost of 1 unit of paper in Country A is 1 unit of cars while Country X's selling price of 1 unit of paper is 0.5 units of cars)
the lowest possible price which Country A can offer is higher than the price offered by Country X
OR
Country B's gain from importing paper from Country X is greater than the maximum possible gain from importing paper from Country A. (2)

2004/CE/1/11(a)

- (i) No, because (1)
with the same amount of resources, Economy A produces a smaller amount of output than HK. / Economy A has a lower productivity than HK in producing clothing. (1)
- Comparison of output: 10 units vs 12 units **OR** 20 units vs 24 units (1)
- (ii) The opportunity cost of producing one unit of car in Economy A is 2 units of clothing. (1)
The opportunity cost of producing one unit of car in HK is 4 units of clothing. (1)
i.e. lower opportunity cost in Economy A. (1)
- ∴ Economy A has a comparative advantage in producing cars. (1)
- To trade at 5 units of clothing to 2 units of cars, Economy A gains $(5/2 - 2) = 0.5$ units of clothing from each car exported. (2)

2005/CE/1/10

- (a) (i) Country B. This is because (1)
(with the same amount of resources,) the quantity of output of Country B is larger than that of Country A. (1)
- (ii) - different education and training
- different degree of technological advancement
- different degree of division of labour
- different working environment
- different labour incentives (1@, max: 3)
- [Mark the **FIRST THREE** points only.]

- (b) (i) Principle of comparative advantage: If each country specializes in the production of the good it has a lower opportunity cost, then the total output of all countries will increase (2)

The opportunity cost of producing 1 unit of watches

- in Country A: $5 \div 10 = 0.5$ units of TV sets. (1)
in Country B: $15 \div 20 = 0.75$ units of TV sets. (1)
(i.e., the opportunity cost of producing watches in Country A is lower than that in Country B.)
Therefore, Country A should produce and export watches. (1)

- (ii) (i) The possible range of mutually beneficial terms of trade is
 $0.5 \text{ units of TV sets} < 1 \text{ unit of watches} < 0.75 \text{ units of TV sets}$ (2)
- (ii) (A country has to compare the terms of trade with its own opportunity cost of production of the good in order to determine whether it should export or import the good.)
If the export price of Country A (the watch exporting country) is lower than its own opportunity cost of production which is 0.5 units of TV sets, Country A would lose from the trade.
OR
If the import price of Country B (the watch importing country) is higher than its own opportunity cost of production which is 0.75 units of TV sets, Country B would lose from the trade. (4)

2006/CE/1/8

- (a) The opportunity cost in the production of 1 unit of clothing
in Country A is $200 \div 100 = 2$ units of computers (1)
in Country B is $450 \div 150 = 3$ units of computers (1)
Therefore, Country A has the comparative advantage in producing clothing. (1)
- (b) Country A gains $2.5 - 2 = 0.5$ units of computers from 1 unit of export. (1)
(1)

2007/CE/1/10(b)

- (i) $(10 - 5)$ units of vegetables
 $= 5$ units of vegetables (1)
(2)
- (ii) 5 units of vegetables < 1 unit of jewels < 9 units of vegetables
OR
 $1/9$ units of jewels < 1 unit of vegetables $< 1/5$ units of jewels (3)

2008/CE/1/7

- (a) No because (1)
they have the same amount of output with the same amount of resources (2)
- (b) The opportunity cost of producing food
in Country A = $50 \div 20 = 2.5$ units of machines (1)
in Country B = $60 \div 40 = 1.5$ units of machines (1)
- Yes because (1)
the opportunity cost of producing food in Country B is lower. (1)

2009/CE/1/10(b)

- (i) The opportunity cost of producing one unit of computers
in Mainland China: $90 \div 50 = 1.8$ units of toys (1)
in Taiwan: $250 \div 200 = 1.25$ units of toys (1)
Taiwan enjoys a comparative advantage in producing computers, because she has a lower opportunity cost in producing computers. (1)
- (ii) Gain of Taiwan from exporting a unit of computers = $(1.5 - 1.25 - 0.2) = 0.05$ units of toys (1)
(2)

2010/CE/1/10(b)

- (i) If each economy specializes to produce the good in which it enjoys a comparative advantage in production / lower opportunity cost of production, the total output of all economies will increase. (2)
- (ii) In HK: the opportunity cost of producing 1 unit of medicine is 2.5 units of watches
In Japan: the opportunity cost of producing 1 unit of medicine is 2 units of watches.
- The possible range of mutually beneficial terms of trade is
2 units of watches < 1 unit of medicine < 2.5 units of watches (4)

2012/DSE/11/9

- (a) In country A, opportunity cost of producing 1S = 0.2W (1)
In country B, opportunity cost of producing 1S = 0.25W (1)
- (b) If each country specializes in producing the good in which the country has a lower opportunity cost, the total output will increase. (2)
Country A would export shirts. (1)
- (c) $0.2W < 1S < 0.25W$ **OR** $4S < 1W < 5S$ (2)

2013/DSE/11/5

- (a) In Country A, the opportunity cost of producing 1 smartphone (S) = 0.75 Food (F) (1)
In Country B, the opportunity cost of producing 1 smartphone (S) = 0.5 Food (F) (1)
Country B has a comparative advantage in producing smartphones. (3)
- (b) Yes, because the potential gain from trade $(0.75F - 0.5F = 0.25F)$ per unit of smartphones is greater than the transportation cost (0.2F). (3)

2014/DSE/11/8

- (a) In Country A, the opportunity cost in producing 1 unit of watches (W) = 4 units of Paper (P). (1)
In Country B, the opportunity cost in producing 1 unit of watches (W) = 2 units of Paper (P). (1)
Country B will specialize in producing watches and export watches because the opportunity cost of producing watches is lower there than in Country A. (3)
- (b) The terms of trade is $1W = 2.5P$. Per unit of watches imported, Country A will gain 1.5 P (= $4P - 2.5P$). (3)

2015/DSE/11/7

- (a) Uncertain. Since the amount of resources owned by the two countries is not given, their productivities (i.e., output-input ratios) cannot be determined and compared. (2)
- (b) In Country A, the opportunity cost in producing 1 unit of clothing (C) in terms of rice (R) = $15/3 = 5$ units of rice (R). (1)
In Country B, the opportunity cost in producing 1 unit of clothing (C) in terms of rice (R) = $8/4 = 2$ units of rice (R). (1)
Therefore Country A (B) enjoys comparative advantage in producing rice (clothing). (2)
- Per unit gain from trade for Country B = $4R - 2R = 2R$
Total gain from trade = $(4R - 2R) \times 3 = 6R$
OR
In other words, Country B would be the clothing-exporting country, producing 4C, exporting 3C in exchange for 12R and keeping 1C for domestic consumption. (1)
Without trade, it could have produced 1 C and 6R on its own. Its total gain from trade is thus 6R (= $12R - 6R$). (2)

2016/DSE/11/7

- (a) In Country A, the opportunity cost of producing 1C = $6/2 = 3T$ (1)
The terms of trade: 1C will exchange for $(1/2) = 0.5T$ (1)
As the opportunity cost of producing 1 C is lower than the terms of trade, Country A will produce and export C. (3)
- (b) The gain from trade = $5.5 - 3 - 2 = 0.5T$ per unit of C (3)

2017/DSE/11/7

- (a) (i) Uncertain. Without knowing the total amount of resources of both countries, the productivity (output per unit of resource) for food and computer cannot be determined. (2)
- (ii) Total producible outputs in the two countries when they utilize all of their resources in producing either food or computer:

	Food (units)	Computer (units)
Country A	200	100
Country B	200	200

- The opportunity cost of producing 1 unit of computer in Country A:
= $200/100 = 2$ units of food (1)
- The opportunity cost of producing 1 unit of computer in Country B:
= $200/200 = 1$ unit of food (1)
Country B has a lower opportunity cost in producing computers, so it will produce and export computers. (1)
- (b) Terms of Trade (TOT) = $7/4 = 1.75 F$ per unit of C (1)
Per unit gain for Country B = $(1.75 - 1)F = 0.75F$ (1)
Total gain = $0.75 \times 16 = 12F$ (1)

2018/DSE/11/8

- (a) The opportunity cost of producing 1T in China = 5C (1)
The opportunity cost of producing 1T in Japan = 2C (2)
- (b) If each country specializes in producing the good in which the country has lower opportunity cost, then total world output would increase. Japan would export toys, as it has a lower cost of producing toys than China. (3)
- (c) Range of TOT: $2.05C < 1T < 4.95C$ (2)

2019/DSE/11/8

- (a) (i) **Yes.** (2)
When Country B has the same resource as Country A, the output of cars would be 200 units which is higher than that of country A.
- (ii) **Yes.** (3)
The opportunity cost of producing 1C in Country A = 1T
The opportunity cost of producing 1C in Country B = 0.6T
Country B has a comparative advantage in producing cars.

2020/DSE/II/7

7A) Country B. The production cost of toy is lower than country A. (0.5 car lower than 1 car)

B. Terms of trade 5 toys for 4 cars = 1 toy for 0.8 car. (1 mark)

Exporting country gain = Terms of trade - exporting country production cost - transportation cost.
= 0.8 car - 0.5 car - 0.1 car = 0.2 car. (2 marks)

2021/DSE/II/8

Opportunity cost of producing 1R in Country A = 0.4W

Opportunity cost of producing 1R in Country B = 0.5W

Mutually beneficial terms of trade: $0.4W < 1R < 0.5W$

OR

Opportunity cost of producing 1W in Country A = 2.5R

Opportunity cost of producing 1W in Country B = 2R

Mutually beneficial terms of trade: $2R < 1W < 2.5R$

7.2 TRADE BARRIERS

Multiple Choice Questions

1990/AL/II/22

The major difference between a quota and a tariff on imports lies in their effects on

- A. wealth redistribution.
- B. domestic production.
- C. domestic consumption.
- D. the price level.

1994/AL/II/30

Tariffs protect _____.

- A. consumers
- B. the import-competing industries
- C. the export industry
- D. both the import-competing and the export industries

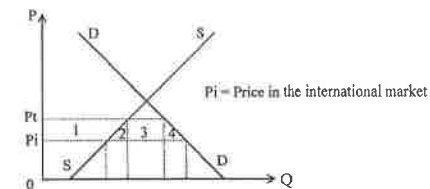
1996/AL/II/29

Which of the following is **NOT** the effect of imposing tariffs?

- A. The quantity of imports is reduced.
- B. The amount of deadweight loss is greater than the total loss of consumer surplus of local consumers.
- C. Local consumers consume more domestically-produced import-competing goods.
- D. Domestic production in import-competing industries will increase.

1998/AL/II/28

Consider a small country imposing a tariff on an import. The diagram below shows the country's supply of and demand for the good.



If the tariff rises the domestic price of good from P_i to P_t , then

- A. the consumers will lose areas 2, 3, 4.
- B. the whole country will lose areas 1, 2, 3 and 4.
- C. the tariff revenue collected by the government is areas 1, 2 and 3.
- D. None of the above.

1998/AL/II/29

Which of the following is **NOT** a result of the imposition of quotas on imports?

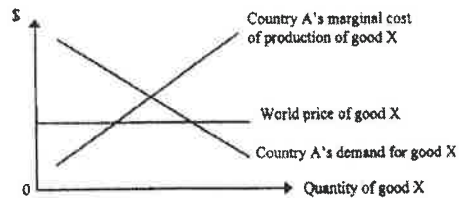
- A. a decrease in the quantity of imports.
- B. an increase in the total expenditure on imports.
- C. an increase in import prices.
- D. an increase in domestic production.

1999/AL/II/21

A major difference between a quota and a tariff on imports lies in their effects on

- A. the price of imports.
- B. the quantity of imports.
- C. domestic production of import substitutes.
- D. wealth distribution.

2000/AL/II/26



Given that the world price of good X is fixed, if country A's marginal cost of production of good X increases, which of the following statements are correct?

- (1) The total production of good X in country A will fall.
- (2) The quantity of good X imported by country A will increase.
- (3) The consumer surplus of good X in country A will fall.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2001/AL/II/11

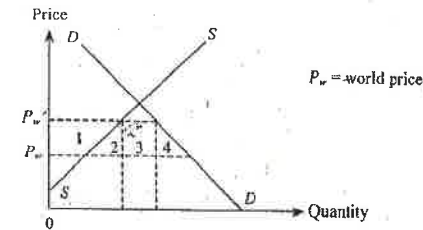
A small country imposes tariffs on good X. Suppose the demand of the country for good X increases,

- (1) the government revenues from tariffs will increase.
- (2) the price of good X in the country will rise.
- (3) the consumption of good X in the country will increase.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2004/AL/II/25

Consider a country imposing a quota on an import. The diagram below shows the country's supply of and demand for the good.

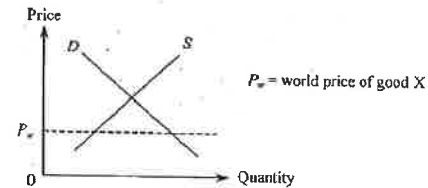


If the quota raises the domestic price of the good from P_w to P_w' ,

- A. total loss in consumer surplus is equal to the sum of areas 1, 2 and 3.
- B. total quota rent is equal to area 3.
- C. total deadweight loss is equal to area 4.
- D. None of the above.

2004/AL/II/26

A country imposes a tariff on good X. Which of the following will be a result of the tariff?



- A. The domestic production of good X will decrease.
- B. The domestic price of good X will increase.
- C. Total expenditure on the import of good X will decrease.
- D. The quantity of import of good X will increase.

2007/AL/II/25

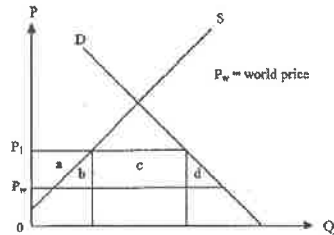
Consider a small open economy with an import quota imposed on a good. If the domestic cost of production for the good increases,

- (1) the domestic price of the good will rise.
- (2) the quantity of the good consumed domestically will fall.
- (3) the quantity of the good produced domestically will remain unchanged.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2009/AL/11/25

Suppose a country imposes a quota on an imported good. The diagram below shows the country's supply of and demand for the good.



If the quota raises the domestic price of the good from P_w to P_1 ,

- A. the loss to the consumers is area a.
- B. the gain of local producers is area a.
- C. the loss to the country is the sum of areas b, c and d.
- D. the quota rent earned by the government is the sum of areas b, c and d.

2009/AL/11/26

An export subsidy will

- (1) reduce the price of exports of the domestic country.
- (2) increase the quantity demanded for exports by foreign consumers.
- (3) improve the trade balance of the domestic country.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

2010/AL/11/27

If a small country reduces the tariff rate of its imported good X,

- A. the local producers will reduce their production.
- B. the producer surplus of the local producers will increase.
- C. the tariff revenue of the government will decrease.
- D. the world price of good X will decrease and its import volume in the country will increase.

2012/AL/11/24

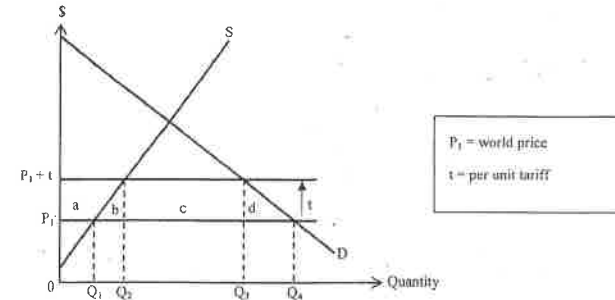
A small open economy imposes a tariff on imported good X. If the local supply of good X in the economy increases and replaces some of the imports,

- (1) government revenue from the tariff will fall.
- (2) the deadweight loss will remain unchanged.
- (3) the price of good X in the economy will fall.
- (4) the producer surplus of the local suppliers will rise.

- A. (1) and (2) only
- B. (1) and (4) only
- C. (2) and (3) only
- D. (2) and (4) only

2014/DSE/1/45

The following diagram shows the imposition of an import tariff on a good in a small open economy. After the imposition of the tariff, which of the following statements about the good in this economy is **INCORRECT**?



- A. The volume of imports is $(Q_3 - Q_2)$ units.
- B. The domestic consumption is Q_3 units.
- C. The increase in producer surplus of the domestic producers is area a.
- D. The total amount of tariff is the sum of areas b, c and d.

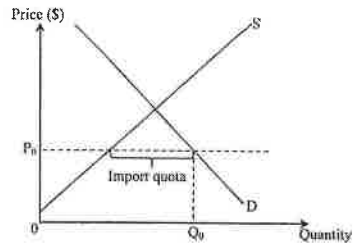
2015/DSE/1/45

The supply curve of a certain good is upward-sloping in a small open economy. What is the main difference between imposing an effective import quota and a tariff on the good?

- A. Imposing an effective import quota will lower the volume of import while imposing a tariff will not.
- B. Imposing an effective import quota will result in a rise in consumer surplus of the good while imposing a tariff may not.
- C. Imposing a tariff will raise the world price of the good while imposing an effective import quota will not.
- D. Imposing a tariff will result in an increase in the government revenue while imposing an effective import quota may not.

2016/DSE/1/42

Refer to the following supply-demand diagram about Good X in a small country.

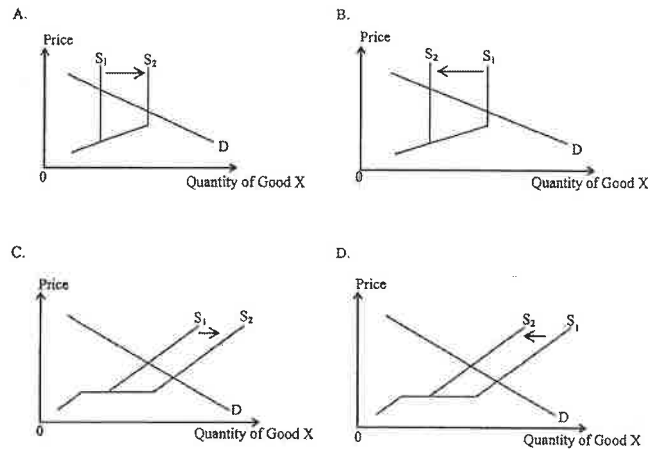


The country has imposed an import quota on Good X and the price and quantity transacted are P_0 and Q_0 respectively. If the demand for Good X in the country increases,

- (1) the import volume will increase.
 - (2) the price of Good X in the country will increase.
 - (3) the quantity sold of Good X in the country will increase.
- A. (1) and (2) only
B. (1) and (3) only
C. (2) and (3) only
D. (1), (2) and (3)

2017/DSE/1/42

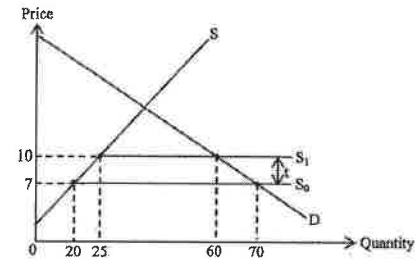
A small open economy increases the import quota for Good X. Which of the following diagrams best illustrates the effect of this change?



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2018/DSE/1/41

The following diagram shows an imposition of import tariff on a good of a small open economy.

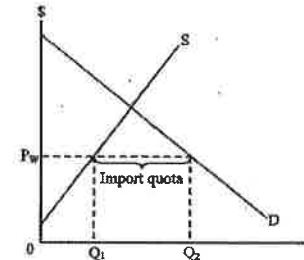


Referring to the above diagram, which of the following statements are correct after the imposition of import tariff (t)?

- (1) The total amount of tariff received by the government is \$105.
 - (2) The revenue of domestic producers will increase by \$110.
 - (3) The volume of imports drops by 15 units.
- A. (1) and (2) only
B. (1) and (3) only
C. (2) and (3) only
D. (1), (2) and (3)

2019/DSE/1/43

The following is the supply-demand diagram of Good X in a small open economy.

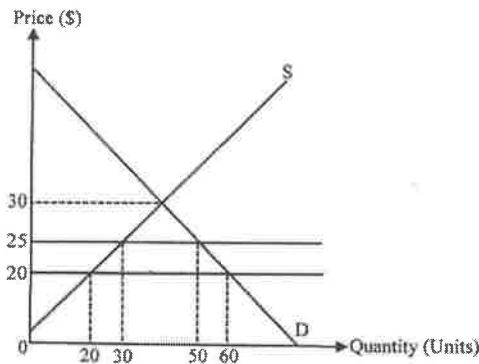


Initially the economy imports Good X at the world price (P_w) and the government imposes an import quota of $(Q_2 - Q_1)$ units. Suppose the world price of Good X drops. Which of the following statements is correct?

- A. The domestic price of Good X will remain at P_w .
- B. The domestic price of Good X will fall.
- C. The domestic supply curve will shift to the right.
- D. The quantity of domestically produced Good X will increase.

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Suppose the world price of soybeans is \$20. A small open economy imposes a per unit tariff of \$5 on imported soybeans. The diagram below shows the economy's supply and demand curves of soybeans.

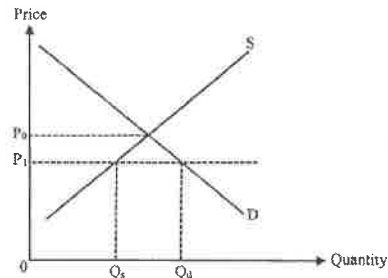


Which of the following statements about soybeans is correct?

- A. The total revenue of domestic producers is \$400 after the imposition of tariff.
- B. The total import value inclusive of tariff is \$500.
- C. If the tariff is raised to \$15, this economy will become an exporter of soybeans.
- D. If the tariff is abolished, the total import value will be \$400.

2020/DSE/1/43

The diagram below shows the market situation of Good X in a small open economy.



P_0 is the price before trade and P_1 is the price after trade. Which of the following statements about Good X are correct after the economy opens up for international trade?

- (1) The total expenditure on Good X of domestic consumers would be $P_1 \times Q_d$.
- (2) The value of domestically produced Good X would be $P_1 \times Q_s$.
- (3) The shortage of Good X would be $Q_d - Q_s$.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (1), (2) and (3)

Short & Structured Questions

1993/AL/11/5

With the aid of diagrams, compare the income redistributive effects on a country imposing tariffs and quotas on its imports. (8 marks)

1995/AL/11/8

With the aid of one diagram only, answer (a) and (b).

- (a) A small country wishes to protect its industry X by restricting the import of good X to a given quantity. Show that this can be achieved by imposing either a quota or a tariff on good X. (3 marks)
- (b) Suppose the demand of the small country for good X increases but the quota or the tariff rate imposed remain unchanged. Compare the impact of this increase on the domestic price, import volume and consumer surplus of good X under the quota system and the tariff system. (7 marks)

2001/AL/11/4

With the help of a diagram, explain how the imposition of tariffs affects the producer surplus, the consumer surplus and the welfare of a small country. (8 marks)

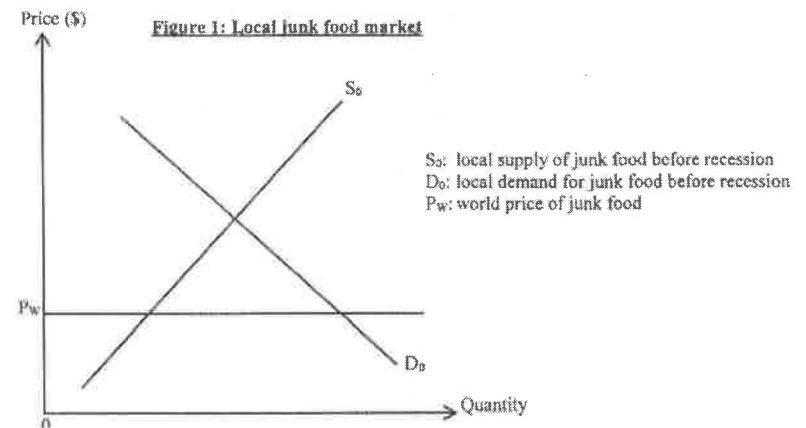
2011/AL/11/1(d)

Name one similarity and one difference between the following pairs of terms: tariff, quota (3 marks)

2021/DSE/11/9

A small open economy imports junk food from other countries although such food is also produced by local manufacturers. During economic recession, local people consume more junk food. To improve public health, the government imposes an effective quota on the imported junk food.

- (a) Explain whether junk food is a normal good or an inferior good in the economy. (2 marks)
- (b) With respect to the imposition of an effective quota during economic recession, indicate the amount of quota as Q_A and the final equilibrium point as E_A in Figure 1. (4 marks)



MARKING SCHEME

1990/AL/II/22 A	1998/AL/II/29 B	2004/AL/II/25 B (63%)	2009/AL/II/26 A (45%)	2015/DSE/I/45 D (68%)
1994/AL/II/30 B	1999/AL/II/21 D	2004/AL/II/26 B (67%)	2010/AL/II/27 A (62%)	2016/DSE/I/42 C (56%)
1996/AL/II/29 B	2000/AL/II/26 A	2007/AL/II/25 A (70%)	2012/AL/II/24 B (63%)	2017/DSE/I/42 C (57%)
1998/AL/II/28 D	2001/AL/II/11 B	2009/AL/II/25 B (77%)	2014/DSE/I/45 D (64%)	2018/DSE/I/41 D (43%)

Note: Figures in brackets indicate the percentages of candidates choosing the correct answers.

2019/DSE/I/43 A	2020/DSE/I/43 A	2021/DSE/I/44 B
1993/AL/II/5		

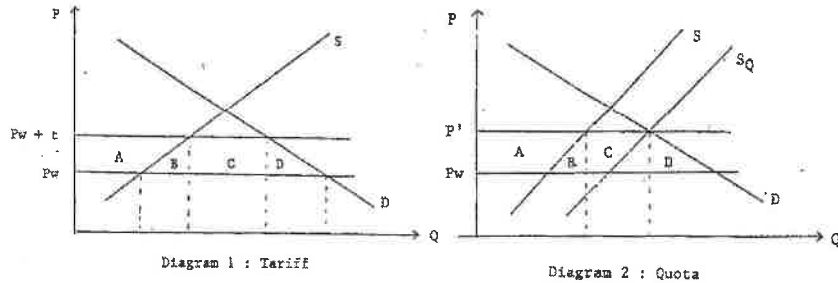
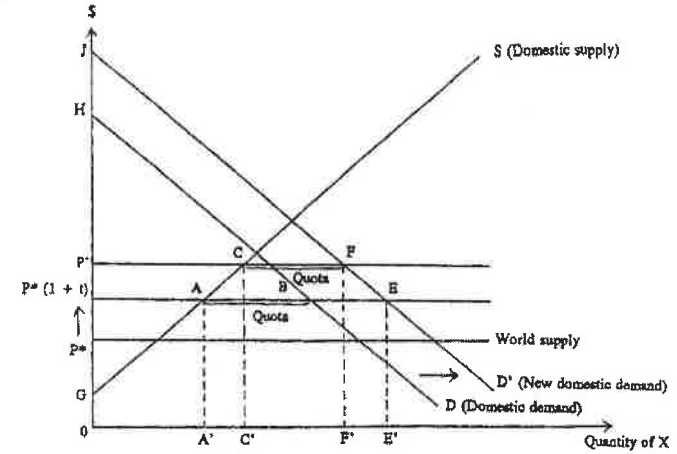


Diagram 1 summarizes the effect of a tariff:
 Area A: increase in domestic producers' surplus
 Area A + B + C + D: decrease in consumers' surplus
 Area C: tariff revenue accruing to the government
 Area B and D: deadweight loss to society

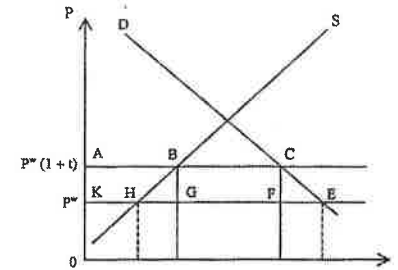
In diagram 2, a quota results in the supply curve S_0 . Areas A, [A + B + C + D], [B and D] have the same interpretation as before. C is no longer tariff revenue. C may be captured by the importers, foreign exporters or the government depending on how the import quotas are allocated.

1995/AL/II/8



- Suppose the country wishes to restrict the imports of X to AB. This can be achieved by imposing a quota of AB or a tariff of t.
- After the demand grows, under the original tariff rate, the price remains to be $p^*(1+t)$ and the import becomes AE. Under the original quota, the price becomes P' [higher than $p^*(1+t)$] and the import is CF (= AB) [smaller than AE]. The consumer surplus under the tariff system is $p^*(1+t)EJ$ [which is larger than] $P'FJ$ under the quota system.

2001/AL/II/4



In the absence of tariffs, the price in the domestic economy is P^w . After imposing tariffs, domestic price is raised to $P^w(1+t)$. Producer surplus is increased by ABHK. Consumer surplus is reduced by ACEK. Tariff revenue collected by the government is BCFG. Loss in welfare is given by BGH + CEF.

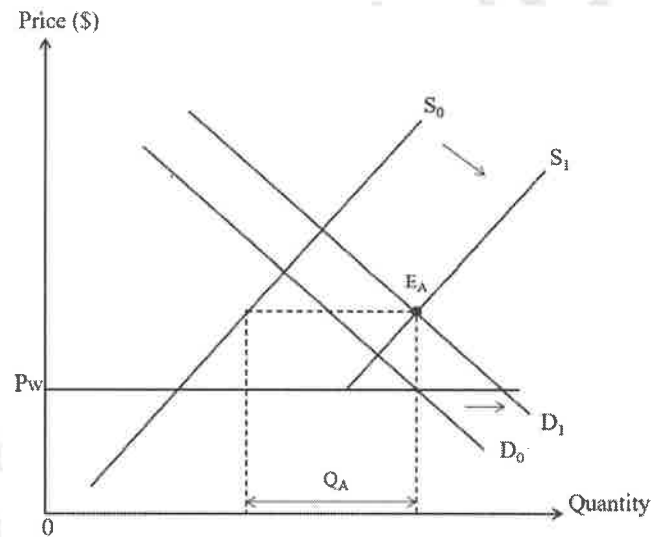
- 2011/AL/II/1(d)
 S: examples of trade protection
 D: direct vs. indirect effects on price of imports.

OR
 indirect vs. direct effects on quantity of imports.

(a) Inferior good, the demand for junk food increases when the income of people increases.

(b) Illustrate in the diagram:

- Increase in demand
- Shift in supply from S_0 to S_1
- Final equilibrium point (E_A)
- Amount of Quota (Q_A)



Section 4: Exchange Rates

SECTION 4: INTERNATIONAL FINANCE

4.1 EXCHANGE RATES

Multiple Choice Questions

MCQ1104

Which of the following will have favourable effects on the current account of Hong Kong's balance of payments?

- (1) A Japanese tourist spends a day in the Great Wall.
- (2) An American bank sets up a representative office in Hong Kong.
- (3) The Hong Kong government buys a computer system from the USA.
- (4) A Hong Kong tourist receives a package from the US States.

- A. (1) and (2) only
- B. (1) and (3) only
- C. (2) and (3) only
- D. (2) and (4)

MCQ1105

There will be a worsening of both the balance of payments and the balance of trade if

- A. exports increase
- B. imports decrease
- C. exports fall and imports increase
- D. the government increases net foreign investment

MCQ1106

Which of the following is NOT an effect of a depreciation of the Hong Kong dollar?

- A. a favourable effect on Hong Kong's balance of payments
- B. an increase in Hong Kong's current account
- C. a shift towards a higher exchange rate of Hong Kong's dollar with the dollar
- D. a favourable effect on Hong Kong's GDP

MCQ1107

The total income earned from exports in Canada and shipped to Hong Kong by a Hong Kong citizen

- A. is included in the GDP of Hong Kong
- B. has a favourable effect on Hong Kong's balance of trade
- C. has a favourable effect on Hong Kong's balance of payments
- D. has income in Hong Kong