

1. ____/25
2. ____/15
3. ____/5
4. ____/20

Total: ____/65

Name: _____

Period: _____

Problem Set #6 Micro Unit 6

: International Trade and FOREX

1. (____/25 Points) Comparative Advantage

The following figures represent the amount that can be produced with a fixed amount of factor inputs.

	Bananas	Sugarcane
Jamaica	100	50
Puerto Rico	160	40

- a. Which country has the absolute advantage in bananas? Which country has the absolute advantage in sugarcane? Explain how you arrive at that answer? (____/5)
- b. What is Jamaica's opportunity cost for producing one unit of bananas? What is Puerto Rico's opportunity cost for producing one unit of sugarcane? (____/5)
- c. Which country has the comparative advantage in bananas? Which country has the comparative advantage in sugarcane? Explain how you arrive at that answer? (____/5)
- d. Should these countries trade? If so, how should they specialize and why? (____/5)
- e. Would the countries trade 1 Sugarcane for 1 banana? 2.5 bananas? 3 bananas? 5 bananas? What is the range that they would trade 1 Sugarcane for? (____/5)

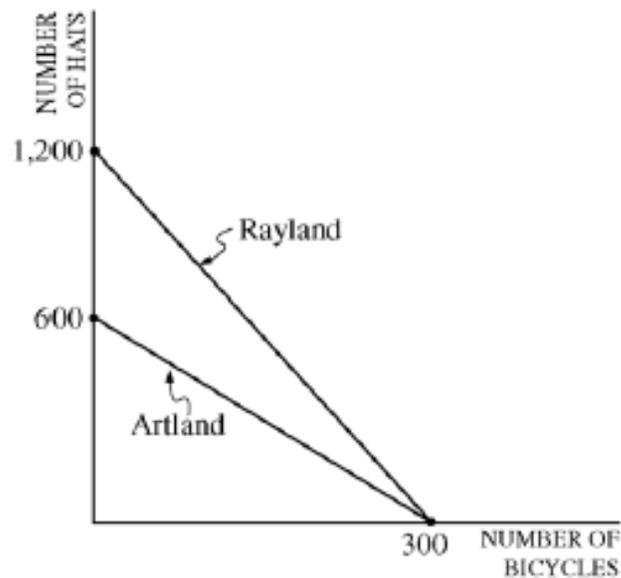
2. (____/10 Points) International Trade and Foreign Exchange

- a. Define trade surplus and trade deficit. Use examples to explain the difference between the current account and the capital account. (____/5)
- b. Explain the difference between appreciation and depreciation. Use supply and demand of US dollars to fully explain a situation that would cause the US dollar to depreciate. (____/5)
- c. Use a forex graph to show what would happen to U.S. dollars and British pounds if Britain wanted to import Xboxes from U.S. (____/5)

3. Video Notes (____/5)

4. (____/20 Points) Practice FRQs

- a. FRQ #1 (____/6)
- b. FRQ #2 (____/7)
- c. FRQ #3 (____/7)



The diagram above shows the production possibilities curves for two countries: Artland and Rayland. Using equal amounts of resources, Artland can produce 600 hats or 300 bicycles, whereas Rayland can produce 1,200 hats or 300 bicycles.

- (a) Calculate the opportunity cost of a bicycle in Artland.
- (b) If the two countries specialize and trade, which country will import bicycles? Explain.
- (c) If the terms of trade are 5 hats for 1 bicycle, would trade be advantageous for each of the following?
 - (i) Artland
 - (ii) Rayland
- (d) If productivity in Artland triples, which country has the comparative advantage in the production of hats?

2. Assume that South Korea and Canada are trading partners. Complete the following regarding the Canadian dollar and the South Korean currency, the won.

- (a) Draw a correctly labeled graph for the foreign exchange market for the Canadian dollar.
- (b) Explain how each of the following will affect the demand for the Canadian dollar.
 - i. The inflation rate in Canada is higher than the inflation rate in South Korea.
 - ii. Real interest rates in Canada fall relative to real interest rates in South Korea.
- (c) Given your answer in part (b) (ii), indicate how the value of the Canadian dollar is affected.
- (d) As a result of the currency change in part (c), what will happen to Canadian exports to South Korea? Explain.

3. Assume that the real interest rate in both the United States and the European Union equals 4.5 percent.

- (a) Assume that the real interest rate in the United States falls to 3.75 percent.
 - (i) How will the flow of financial capital between the United States and the European Union be affected? Explain.
 - (ii) Using a correctly labeled graph of the foreign exchange market for the euro, show how the value of the euro would change relative to the United States dollar in a flexible exchange rate system.
- (b) Explain how the change in the value of the euro in part (a)(ii) would affect the European Union's net exports.