



Economic Detective

Learning to Trade

Problem

For centuries the people of Newland have supplied most of their needs by grazing sheep and cattle on their rolling grasslands. However, their new economic chairperson, Ms. Bankstreet, wants to expand Newland's economy through trade.



Investigation 1

Sure that Newlanders can surpass neighboring Westlanders at producing wool and cheese, Ms. Bankstreet instructs Newlanders to alternate producing the two products on a monthly basis to determine which to sell to Westland and other regions. The first year's production reports show that Newlanders can produce 1,000 pounds of cheese or 400 pounds of wool monthly. Comparable Westland figures indicate monthly production of 300 pounds of cheese or 1,000 pounds of wool. The next year, Ms. Bankstreet directs Newland producers to stop producing wool and to concentrate on making cheese.

1. What absolute advantage does Newland have over Westland? _____

2. What is the opportunity cost of Ms. Bankstreet's decision for the second year? _____

3. Why is Ms. Bankstreet's decision a wise one? _____



Investigation 2

Newland's cheese exports are so successful that before long it is selling much more to Westland than it is buying. The new income encourages a number of entrepreneurs to try their hand at manufacturing leather shoes. Newlanders have been buying shoes from neighboring Eastland, so Ms. Bankstreet is pleased that they may be able to buy their shoes from home producers. To help the entrepreneurs, Ms. Bankstreet first severely limits shoe imports from Eastland, but Newland's growing cheese exports to Eastland suffer. She soon reconsiders and decides just to tax shoes imported from Eastland. Newlanders complain about higher-priced shoes, so she reconsiders again and merely requires Eastlanders to obtain a license to sell their shoes in Newland.

1. With which of its neighbors does Newland have a trade surplus? _____
2. For what industry does Ms. Bankstreet practice protectionism? _____
3. (a) What trade quota does Ms. Bankstreet set up? _____
(b) What tariff? _____
(c) What formal trade barrier? _____
4. (a) How does the trade quota on shoe imports from Eastland affect Newland? _____
(b) The tax on imported shoes? _____



Investigation 3

Eastland's leaders soon respond to Newland's protectionism by placing an import tax on Newland cheese. Before long, leaders from both countries meet to review trade relations. They agree to lower all trade barriers and ask Westland to do the same. Westland agrees. The trading partners further ease trade by valuing their currency in terms of Eastland's decem, one of which is worth two Westland quatros and four Newland centras.

1. At what point does Newland become engaged in a trade war? _____
2. What free-trade zone grows out of the trade war? _____
3. Is the exchange-rate system in the new free-trade zone flexible or fixed? _____
4. (a) What is Newland's exchange rate with Eastland? _____
(b) With Westland? _____

© Prentice-Hall, Inc.