1. Define the following terms: production possibility frontier, marginal rate of transformation, absolute advantage, comparative advantage, terms of trade, domestic price ratio, and international price ratio.

2. Describe the differences between Adam Smith’s and David Ricardo’s explanations for the existence of trade between countries.

3. In country A, if all resources are allocated to only one commodity, either 1000 barrels of oil or 1000 tons of wheat can be produced. In country B, if all resources are allocated to only one commodity, either 3000 barrels of oil or 1500 tons of wheat can be produced. In both countries the marginal rate of transformation is constant.

   (a) In the absence of trade what will be ratio of the price of oil to the price of wheat in each country?
   (b) If trade is permitted (at zero transportation costs), which country will export which commodity and within what range will the terms of trade end up.
   (c) Which country will potentially gain from trade; A, B, or both A and B?

4. In country X, the price of beer is $5 a six pack and the price of rice is $2 a pound. In Country Y the same six pack of beer sells for 10 euros and rice for 5 euros per pound. Is trade between the two countries likely and, if so, which country will import which commodity.

5. The United States, like most developed economies, exports many commodities and also imports many commodities. How would Ricardo account for the complex patterns of trade we observe in the real world?