ECONOMICS 542
INTERNATIONAL TRADE
Fall 2010

Problem Set 1
(10 points in total)

Consider a Ricardian model with two countries, Home and Foreign, and two goods, cheese *C* and wine *W*. The marginal product of labor (*MPL*) for the two goods in the Home country are: MPL_C = 1/6, MPL_W = 1/4. Those in the Foreign country are: MPL_C * = 1/4, MPL_W * = 1/2. The supply of labor in each country is 20. Assume throughout that the price of wine in each country in both autarky and free trade equilibria is equal to 2.

1. Which country has absolute and which has comparative advantage in which good? (1.5 points)

2. Find the values of P_C, P_C*, *w*, and *w** in the autarky equilibrium, where *P* stands for price, and *w* stands for wage of labor. (2 points)

3. Suppose that with trade, the world relative price of cheese is 7/4 (1.75) and total world exports of wine equal 5. Find the values of P_C, Q_C, Q_C*, Q_W, Q_W*, w, and w* in the free trade equilibrium, where Q stands for the quantity consumed of a good. (3.5 points)

4. In autarky, Home consumes 1⅔ units of cheese while Foreign consumes 1 unit of cheese. Draw and label the export supply curve and import demand curve for cheese. (3 points)