

ECON 136, Fall 2016
Homework assignment #1
Gains from trade
Due Wed. Sep. 7

You may write answers on this paper or use a separate sheet. If you use a separate sheet, attach a copy of this paper. Typed answers preferred. Be sure your name is on your paper.

- Which of these statements are true in the Ricardian model?
 - If Country A has an absolute advantage in product X, it follows that Country B must have an absolute advantage in product Y.
 - **If Country A has a *comparative* advantage in product X, it follows that Country B must have a comparative advantage in product Y. This is what I meant to say. What I actually said on your question sheet is false. ☹**
 - Mutually profitable trade is not possible if Country A has an absolute advantage in both products X and Y.
 - **The Ricardian model does not consider the evolution of comparative advantages over time.**
- Answer question 13, text p. 37. Answer in your own words; do not just copy from the text.
 - **More efficient resource utilization as labor and capital are moved to industries with a comparative advantage**
 - **Gains from increasing returns to scale, as fixed costs are spread over more output**
 - **Enhanced quality and diversity of goods**
 - **Enhanced domestic competition. Example: US auto industry**
- Question 14 abs advantage
 - **Case I: Japan corn, Korea wine**
 - **Case II: Japan corn, Japan wine**
 - **Case III: Japan corn, no advantage wine**
 - **Case IV: Japan corn, Japan wine**
- Question 15 comparative advantage
 - **Case I: Japan corn, Korea wine**
 - **Case II: Japan corn, Korea wine**
 - **Case III: Japan corn, Korea wine**
 - **Case IV: no comparative advantage**
- Question 16, trade possibilities
 - **Cases I, II, III: Japan exports corn, Korea exports wine**
 - **Case IV: No trade opportunity**

- Question 17, Case II 4 corn for 4 wine
 - a. **Japan loses 3 wine to produce 4 corn for export, gains 4 imported wine, net gain 1 wine**
 - b. **Korea loses 2 corn to produce 4 wine for export, gains 4 imported corn, net gain 2 corn**
 - c. **Range is $1C=2W$ (Korea's opp. Cost) to $1C=0.75W$ (Japan's opp cost)**
 - d. **Japan loses 3 wine to produce 4 corn for export, gains 6 imported wine, net gain 3 wine. Korea loses 3 corn to produce 6 wine, gains 4 imported corn, net gain 1 corn. Note that these terms of trade ($4C=6W$) are more favorable to Japan because they are closer to Korea's opportunity cost.**