

ECON 136, Fall 2016
Homework assignment #2
Gains from trade
Due Wed. Sep. 14

Write your answers on a separate sheet, preferably typed. Attach a copy of this question sheet. Be sure your name is on your paper.

- Question 7, p 64. Explain your answer.
- Question 9. Explain your answer.
- Question 10. The question is whether increasing cost conditions result in more trade or less, relative to constant-cost conditions. Explain.
- (This question is adapted from text question 13.) The table below shows the maximum output of beer or chips that the US and Mexico can produce under constant-cost conditions.

	US	Mexico
Beer	30,000	12,000
Chips	5,000	3,000

- a) Graph the production possibilities frontiers for Mexico and the US. Use graph paper, available on the class web site. Draw a large graph, extending the full width of the paper. Put beer on the vertical axis, and label the axes with numbers. Prior to trade, assume the U.S. produces and consumes 18,000 beers and 2,000 chips. Mark this point A. Mexico produces and consumes 8,000 beers and 1,000 chips. Mark this point A'.
- b) Determine the marginal rate of transformation for each country. Which country has a comparative advantage in beer production and which in chip production?
- c) Assume trade begins with terms of trade being one chip for five beers. Assume each country produces only the product for which it has a comparative advantage and trades away some of that product for the other country's product. Specifically, assume 2,000 chips for 10,000 beers. Mark a point at the US consumption combination and label it B. Mark Mexico's combination and label it B'. Does B lie outside the US PPF? Does B' lie outside Mexico's PPF? Do both parties gain from this trade?
- d) Draw a dashed line showing each country's trading possibilities curve.