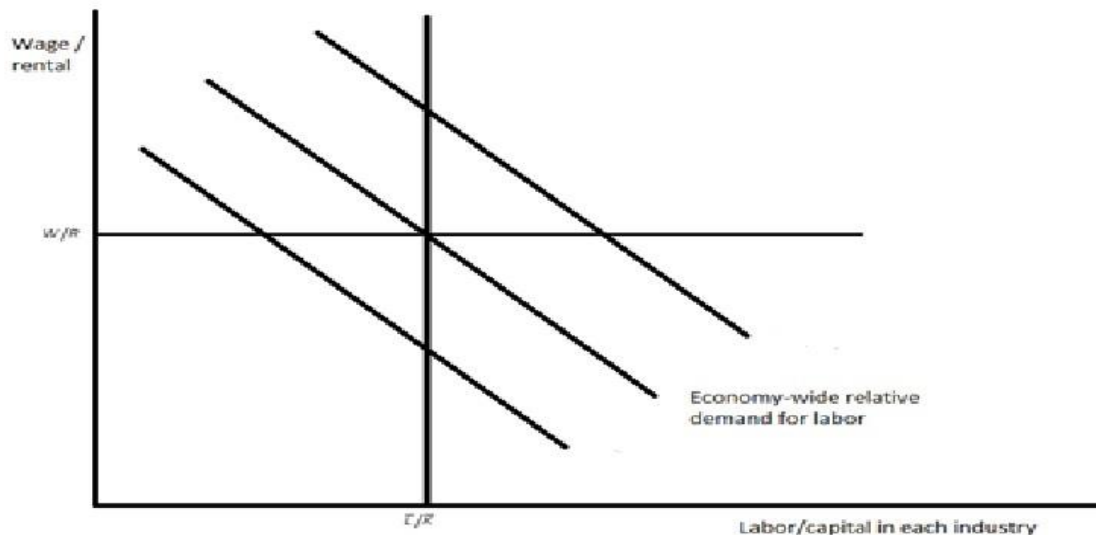


Study Guide Exam 1 – International Trade

1. What is the definition of a trade surplus, trade deficit, and trade balance?
2. What do we mean by absolute advantage? Comparative advantage? Give an example.
3. Why did the mercantilists encourage exports and discourage imports?
4. Be sure to understand the equation $W = MPL \times P$.
5. Set up the basic conditions for the Ricardian model. What are the assumptions?
6. Fully understand the Ricardian model in terms of both the home and foreign countries' PPF, domestic price ratios, and production and consumption decisions under autarky.
7. Now if the two countries engage in trade, what good will each country specialize in?
8. What happens to the terms of trade for each country?
9. Be able to show diagrammatically the effect of trade on both the home and foreign countries' production and consumption decisions.
10. Be able to show the trade triangle for each country.
11. If the home country has a comparative advantage in Good A (relative to B), what is the effect on worker's wages in terms of good A if trade opens up? What is the effect in terms of good B?
12. Be able to derive a home export supply curve and a foreign country import demand curve.
13. What are the assumptions of the specific factors model?
14. How does the PPF in the specific factors model differ from that of the Ricardian model?
15. What determines which good each country will tend to specialize in?
16. Let the two goods in the home market be Good A and Good B. The input specific to Good A is skilled labor and the input specific to Good B is land. Unskilled labor can move between Good A and B. Now assume the price of Good A relative to B rises. What will happen to the production of Good B in the home market? Show diagrammatically the effect of an increase in the price of Good A on the market for labor
17. Show diagrammatically the situation in 16 using a PPF for the foreign market.
18. Which good will the foreign market import? Show on the same diagram.
19. Based on the situation given in question 16, what happens to the nominal wages of unskilled workers in the home market? The real wages?
20. Based on the situation given in question 16, what happens to the income of skilled workers in the home market?
21. Based on the situation given in question 16, what happens to the income of landowners in the home market?
22. Based on the situation given in question 16, what happens to income of unskilled workers in the home market?
23. What are the assumptions of the Heckscher-Ohlin (HO) model?
24. In the HO model, what is the mathematical condition for the home country to be capital abundant?
25. In the HO model, what factor determines which good a country will export?

26. Now assume a home country is capital abundant in electric cars and the foreign country is labor abundant in clothing. Let the world price of electric cars relative to clothing $\left(\frac{P_{EC}}{P_C}\right)^W$ rise so it is now higher than the autarky price $\frac{P_{EC}}{P_C}$ in the home country. You want to find out what will happen to the wage / rental ratio, $\frac{W}{R}$, in the home country after the increase in $\frac{P_{EC}}{P_C}$. Using the diagram below, compare the relative factor prices (wage/rental) in the home country before and after trade. Assume the diagram shows the initial relative demand and supply of labor in autarky.

(Show and label all changes)



27. Using the information from question 26, place arrows below the ratios to show the directional effects on the ratios as a result of trade. Keep in mind we are looking at the ratios of the home country.

$$\frac{\bar{L}}{\bar{K}} = \frac{L_M}{K_M} \left(\frac{K_M}{\bar{K}} \right) + \frac{L_F}{K_F} \left(\frac{K_F}{\bar{K}} \right)$$

28. Based on the information in questions 26 and 27, who gains and loses from international trade? Explain.
29. What do we mean by the Stolper–Samuelson Theorem?