

INTERNATIONAL ECONOMICS

HOMEWORK #1

8/11/2013

Germany and France produce cars and wines with the following unit labour requirements:

	France	Germany
Cars	5	6
Wine	2	6

The total labour forces are 100 and 200 for France and Germany respectively

- (a) Graph the PPF of each country and calculate the opportunity cost of cars in terms of wine. Which country has an absolute advantage in car production, which in wine production. Which country has a comparative advantage in car production and which in wine production? Based on your answer, what is the direction/ pattern of trade between the two countries?
- (b) Using the preceding answer, draw each country's consumption possibilities in the absence of trade. Calculate relative price of cars in terms of wine in autarky.
- (c) Both countries open up to free trade, Graph the relative world supply of cars to wine and its response to the relative world price of cars $\frac{P_c}{P_w}$ based on the unit labour requirements. (*Provide specific values on the axis*)
- (d) World consumer demand for cars relative to wine depends on the relative price of the two goods:

$$(Q_c + Q_c^*) / (Q_w + Q_w^*) = 6 - 5(P_c / P_w)$$

Graph the relative demand curve. Calculate the relative price P_c / P_w of the cars in world trade equilibrium. Calculate the production of Q_c, Q_c^*, Q_w, Q_w^* .