Econ 165 | Stanford University
Winter 2002/03 | Gerald Willmann

Hand-out weeks 3+4

This week:

1. Classical Trade Theory (cont'd)
   - 1.2. Heckscher–Ohlin (cont'd): the Heckscher–Ohlin and Rybczynski results.
   - 1.3. the specific factors model: setup and distributional effects of trade.
2. New Trade: empirical motivation, increasing returns to scale, monopolistic competition, intra-industry trade.

Readings: Krugman&Obstfeld, chpts 3 + 6, and Krugman's chapter in the Handbook of International Economics, Vol 3, North-Holland.

Practice problems:

1. State the Heckscher–Ohlin result. If you wanted to test it, which are the three things you would need to determine about a country and its trade. Given the somewhat unsatisfactory history of such tests, name possible reasons for the discrepancy between the theory and reality.
2. The two countries Hightechnia and Bananarepublic produce computers C and bananas B. Unskilled labor U is mobile between both sectors whereas skilled labor S is specific to computers and land L to bananas. Hightechnia is abundant in skilled labor while Bananarepublic is abundant in land. Both countries have identical (and homothetic) preferences. Graph each country's PPF — how will their autarky price ratios p_C/p_B differ? How does the move from autarky to free trade affect the real incomes in terms of bananas and computers of U, S, and L in each country?
3. Find the trade data at `www.oecd.org` (there is a link on the class website) and pick one industrialized country. What percentage of its trade takes place with other industrialized countries and how much with the developing world?
4. What is the shape of the PPF when there are increasing returns to scale in both sectors? Show that trade takes place and is beneficial even if both countries have exactly the same PPF.
5. Explain the difference between inter-industry and intra-industry trade. Which of the two is explained by old trade theories and which by new trade? Are these competing theories?