Econ 328 University of Illinois
Winter 2003/04 Gerald Willmann

Hand-out week 1+2

This week:

1. Classical Trade Theory

   1.1 the Ricardo model: unit labor requirements, comparative advantage, gains from trade.

   1.2 the Heckscher–Ohlin model: the 2x2x2 setup, four theorems: Stolper–Samuelson, Rybczynski, Heckscher–Ohlin, factor price equalization.

   1.3 the specific factors model: setup and distributional effects of trade.

Readings: Krugman & Obstfeld, chapters 2–5.

Practice problems:

1. How much does "Krugman&Obstfeld" cost abroad? Check online booksellers.

2. Solve problems 1–5, K&O, chpt 2 (feel free to look at problems 6–10).

3. Explain the difference between absolute and comparative advantage. Come up with examples where someone (say you) has an absolute advantage (or disadvantage) in two activities. Who has the comparative advantage? Could one have a comparative advantage in both activities or none?

4. State the Stolper–Samuelson result. Why do we speak of a magnification effect? Show this effect graphically. Now, if one uses the result to explain the increasing wage inequality between skilled and unskilled labor in the U.S., what would be the prediction for our trading partner, say Mexico?

5. K&O problems 4.2 and 4.5.

6. Suppose the U.S. has 40 machines and 200 workers while Canada has only 10 machines and 60 workers. Suppose further that for some given relative factor price one unit of steel requires two machines and eight workers whereas a unit of lumber is produced using one machine and eight workers. Which country is labor abundant, which country capital abundant? Which good is capital intensive, which good labor intensive? Which country will export lumber, which country steel?