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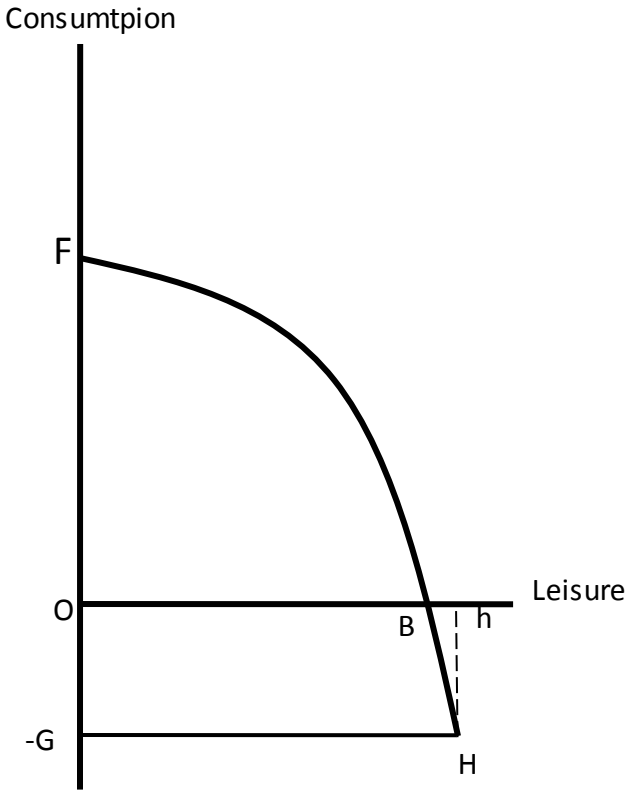
Assignment III: Static General Equilibrium

Due on April 4th ***in class before 11.20 am. Write your answer in this paper.***

Question 1 Use the figure below, and redo the analysis discussed in class. Start with the opposite situation. Assume that when W = 10, the economy is experiencing *an excess supply in labor*. Locate all the points that represent the initial situation. Explain step-by-step why all the located points make sense. Then, analyze the adjustment mechanism and determine the possible competitive equilibrium. Why does your point represent the competitive equilibrium?



Question 2 Suppose there are but two countries, namely A and B. Each country is indexed by "j" for j = A and B. Both countries have no government, i.e. $G_j = T_j = 0$. Suppose the technology of both countries are linear production in labor hours. That is, $y_j = z_j N_j$ where N_j is the number of working hours in country j and z_j is the level of technology in country j. Suppose that $z_A = 2 > z_B = 1$ and preferences of consumers in both countries are identical

a) Assuming a fixed time endowment in both countries to be equal to 1 unit, *construct the PPF of each country*. Putting both PPFs in the same figure and locate all important points. Comments on the differences and similarities between the two PPFs.
b) Determine the competitive equilibrium in both countries. Is there any wage differentials in the equilibrium? Which one of the country is supposed to experience a higher wage? Why? How about the allocation in both countries?
c) Redo the problem "a" and "b" above, but instead assume that the labor endowment in both countries are different, i.e. $h_A = 1$ and $h_B = 4$. Comment on the possible sources that generate the wage differentials, if any?

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