

**EE451 Self Practice (26 September 2018)**

**Problem 1:** You are given of the following Classical-type table showing the number of days of labour input required to obtain 1 unit of output of each of the five commodities in each of the two countries:

	Bread	VCRs	Lamps	Milk	Books
UK	2	8	4	3	2
US	2	6	2	2	3

- A. Assume that the wage rate in the UK is £8 per day, the wage rate in the US is \$20 per day, and the exchange rate is \$2/£1. With this information, determine the goods that will be UK exports and the goods that will be US exports.
- B. Keeping wage rate in the US at \$20 per day, and keeping the exchange rate unchanged, calculate the upper and lower limits (in pounds per day) to the UK wage rate that are consistent with two-way trade between the countries.

**Problem 2:** The table below shows possible terms of trade for country I and country I's corresponding demand for imports of good Y at each terms of trade.

Combinations	Possible terms of trade	Country I's quantity demanded for imports of Y
(a)	1X: 1Y or $P_x/P_y = 1$	20 units
(b)	1X: 2Y or $P_x/P_y = 2$	46 units
(c)	1X: 3Y or $P_x/P_y = 3$	69 units
(d)	1X: 4Y or $P_x/P_y = 4$	84 units

Calculate the supply of exports of good X by country I at each terms of trade and plot the offer curve. What is the nature of the elasticity of demand for imports between [i] points (a) and (b); [ii] points (b) and (c); and [iii] points (c) and (d)? how do you know? What might account for these respective elasticities?

**Problem 3:** When Spain and Portugal joined the European Community (EC) in 1986, the United States had concerns that this phenomenon might have resulted in a shift in demand for agricultural products by Spain and Portugal away from the United States and towards other Community members. In response, the United States threatened to impose stiff trade measures on a variety of exports of the rest of the EC to the US. Using offer curve diagrams for (a) the US and Spain/Portugal, (b) Spain/Portugal and the rest of the EC, and (c) the US and the rest of the EC, illustrate and explain the effects of these potential events on the terms of trade and volume of trade.

**Problem 4:** Suppose when Russia opens to trade, it imports automobiles, a capital-intensive good.

1. According to the Heckscher-Ohlin theorem, is Russia capital abundant or labour abundant? Briefly explain.
2. What is the impact of opening trade on the real wage in Russia?
3. What is the impact of opening trade on the real rental on capital?
4. Which group (capital owner or labour) would support policies to limit free trade? Briefly explain.