

Home assignment 2: Comparative Advantage

Consider two countries, Iceland and Finland.

Finland has $L=300$ units of labor and Iceland has $L^*=100$ units of labor, the only input.

There are two goods – fish (F) and video games (V). In Finland: $MPL_F=1/2$ and $MPL_V=1/4$, in Iceland: $MPL_F^*=1/2$ and $MPL_V^*=1/2$.

Also assume that consumers in both countries have Leontief preferences, consuming F and V in the fixed proportion of one-to-one. That is, the utility of each consumer is $U=\min\{F,V\}$.

- (a) Which country has an absolute advantage in which good(s)?
- (b) What is the opportunity cost of producing fish in Finland (Iceland)? What is the opportunity cost of producing video games in Finland (Iceland)?
- (c) Which country has a comparative advantage in which good?
- (d) Draw the production possibilities frontier for each country. How many units of F and V will be consumed in autarky in each country? How many units of F and V will be produced in autarky in each country?