**International Trade Practice Problem**

1. (a) Which of the following characterize the Heckscher-Ohlin Model? 4
2. Perfect mobility of factors across countries
3. Identical technologies across industries
4. Monopolistic competition
5. Factor intensity reversals

(b) Assume that only two countries, A and B, exist in the world. Refer to the table below which reports the endowments of labour and capital in the two countries and answer the following two questions.

|  |  |  |
| --- | --- | --- |
| **Factor Endowments** | **Countries** | |
| **A** | **B** |
| **Labour Force** | 45 | 20 |
| **Capital Stock** | 15 | 10 |

1. If good S is capital intensive, then according to the Heckscher-Ohlin theory, what would be the pattern of trade? Argue in favour of your answer. 2
2. How will your answer to the above question change if you are told that Country B is **very** much richer than Country A? Argue in favour of your answer. 2
3. Consider the following data on two countries, A and B:

|  |  |  |
| --- | --- | --- |
| Be careful! | Australia | Bolivia |
| 1994 Population (millions of persons) | 17.8 | 7.2 |
| Capital stock per worker (1985 international prices) | $37,854 | $5,721 |

a.       Which country is capital abundant and why?

b.     Which country is labor abundant and why?

c.       Supposing that the good T (toupees) is labor intensive relative to good S (Sombreros), which country will have a comparative advantage in the production of T? Explain your answer.  
  
d.      Which country will have a comparative advantage in the production of S? Explain.   
  
e.       Which factors gain and which lose when trade is opened between the two countries?

3. Assume that two goods, cloth and food, are produced using two factors- labour and land. The input requirements and the endowments are given in the table below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Unit Labor requirement | Unit Land requirement | Labor (L) | Land (T) |
| Cloth | aLC = l0 | aTC = 5 | l00 | l00 |
| Food | aLF = 2 | aTF = 4 |

1. Draw the production possibility frontier with two factors.
2. What happens to domestic production if only the endowment of labour expands by 20 units? Explain your answer with theoretical support.
3. How will be the pattern of trade with a foreign country with identical demand but with a relatively higher endowment of land? 7.5