

Problems: Comparative Advantage

March 16, 2004

Problem 1

	India	UK
Rice (1 kilo)	5	6
Cloth (1 meter)	10	2

1. What is the opportunity cost of producing 1 kilo of rice in India? In UK?
2. If there is no trade what is the relative price of 1m of cloth $\frac{P_c}{P_r}$? (In India and UK)
3. In which good does UK have comparative advantage?
4. If $\frac{P_c}{P_r}=1$ show gains from trade.
5. If $L_{India}=80$ $L_{UK} = 150$ and before trade both countries produce both goods, what will be the production after trade with complete specialisation?

Problem 2

	India	Italy
Wine (1 barrel)	5	8
Cloth (1 meter)	10	2

1. What is the opportunity cost of producing 1m cloth in India? and in Italy? Why?
2. If there is no trade what is the relative price of 1m of cloth $\frac{P_c}{P_w}$ in both the countries?

3. In which good does Italy have comparative advantage? Why?
4. Construct the production possibilities curve for India assuming that 100 labour days exist. Show possible pre-trade equilibrium production points.
5. If $\frac{P_c}{P_w}=1$ show the new equilibrium production point. Show gains from trade.