Sample Problem: Chapter 4

Discussion on Factor Earnings in the HO Model

Suppose the payments to labor and capital in Computers and Shoes are given by the following:

**Computers:**

Sales revenue =PC \* QC = $150

Payments to labor = W \* LC =$50

Payments to capital = R \* KC = $100

**Shoes:**

Sales revenue = PS \* QS = $150

Payments to labor = W \* LS = $100

Payments to land = R \* KS = $50

Suppose, under free trade, the following price changes:

Computers: Percentage increase in price = ΔPC / PC = 5%

Shoes: Percentage increase in price = ΔPS / PS = 0%

**Q1. Which industry is labor intensive? Which industry is capital intensive?**

**Q2. Calculate the Percentage change in Rental on capital for each sector.**

**Q3. Compare the magnitude of the percentage in the rental on capital in Q2 with that of**

**labor**.