CITY UNIVERSITY - DEPARTMENT OF ECONOMICS

EC2004 - International Economics

CLASS EXERCISE 1

1. There are two countries, England (ENG) and Portugal (POR), and two goods, Cloth and Wine. The following table depicts three cases involving *unit labour requirements* for each good in each country (in hours per bale of cloth and hours per litre of wine, respectively).

	CASE 1		**CASE 2**		**CASE 3**	
	ENG	**POR**	**ENG**	**POR**	**ENG**	**POR**
Cloth	1	2	1	2	1	2
Wine	6	4	3	4	2	4

   (a) For each case, identify the pattern of absolute advantage. In case 1, which country has comparative advantage in cloth? In wine?

   (b) For each case, work out the pattern of opportunity costs. In each case, which country has comparative advantage in which good? Are your answers for case 1 consistent between parts (a) and (b)?

   (c) For this and subsequent questions, consider **case 2**. Suppose that England has a labour force of 50,000 (person) hours of which it employs 40,000 hours in cloth production. How much cloth will it produce? How much wine will the remaining labour force produce?

   (d) Suppose that Portugal has 60,000 person hours of which it employs 20,000 hours in cloth production. How much cloth will Portugal produce? How much wine?

   (e) Now suppose that England and Portugal can trade with each other at the relative price of 2.5 bolts of cloth per bottle of wine. Which country will export wine at this relative price? Which country will export cloth?

   (f) Suppose that England exports 10,000 bolts of cloth at this price to Portugal. How much wine will it get in exchange?

   (g) Is each country better off by specialising in its export good and carrying out this trade than in trying to produce and consume in autarky? Explain.

2. Concepts and definitions. Make sure that you are very clear in your mind what these terms mean.
   (a) Absolute advantage.
   (b) Opportunity cost.
   (c) Comparative advantage.
   (d) Labour theory of value.
   (e) Production possibility frontier.
   (f) International budget constraint.
   (g) Gains from trade.