

QUIZ 2

Thursday, January 31 - 20 points

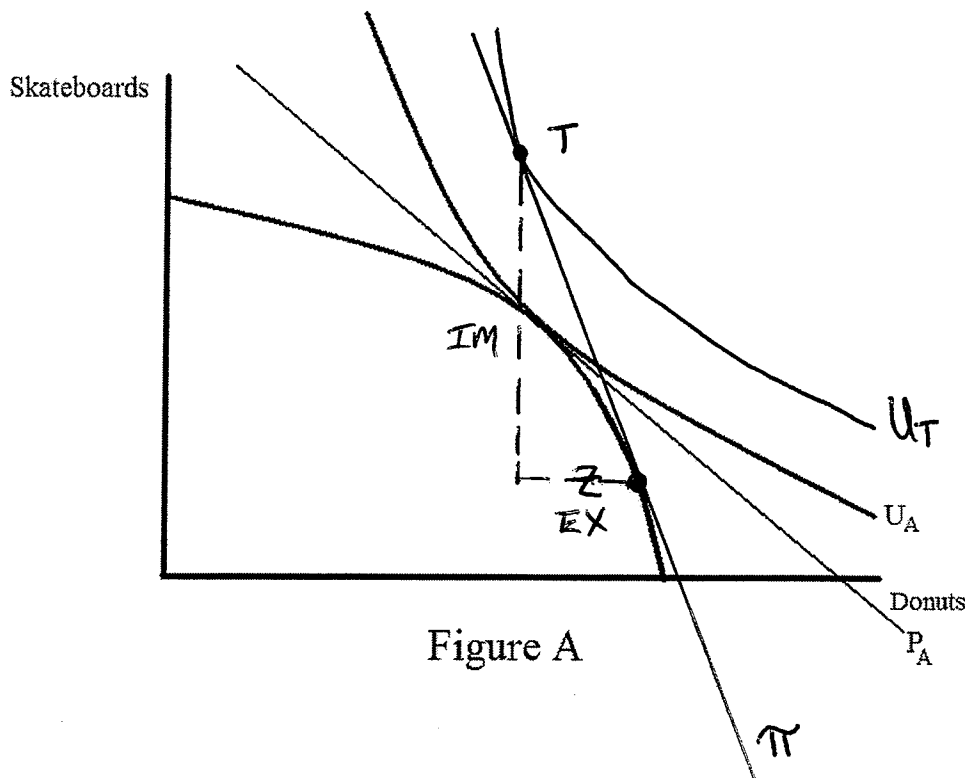
Fill in the blank/short answer. (1.5 points each)

- 1) When it takes less Mexican pesos to purchase a dollar, then the Mexican peso has appreciated (appreciated or depreciated) relative to the U.S. dollar.
- 2) In the Ricardian model, the switch from autarky to trade leads to complete (complete or partial) specialization of production.
- 3) In the Ricardian model, equilibrium autarky prices are unaffected (affected or unaffected) by changes in consumer preferences.
- 4) In the Ricardian model, absolute advantage determines wage rates.

5) TRADE IN A NEOCLASSICAL MODEL (5 points)

Diagram A below shows a country in autarky equilibrium in a standard neoclassical model. Draw into the diagram the following items when the country opens up to trade and the relative international price of donuts is more expensive than the country's autarky price.

- A) The new international price, which you label as " π ".
- B) The amount of production for each good in the trade equilibrium, which you label as "Z".
- C) The relevant indifference curve in the trade equilibrium, which you label as " U_T ".
- D) The amount of consumption for each good in the trade equilibrium, which you label as "T".
- E) The trade triangle, representing the country's exports and imports.



Use the following information to answer questions 6-8 (3 points each):

Assume that we have a Ricardian world with two countries, Teenage Wasteland (TW) and Land of Confusion (LC), and two products, Guns (G) and Roses (R). The following table shows how much labor time it requires in each country to produce each good.

	Guns	Roses
Teenage Wasteland	2	6
Land of Confusion	5	15

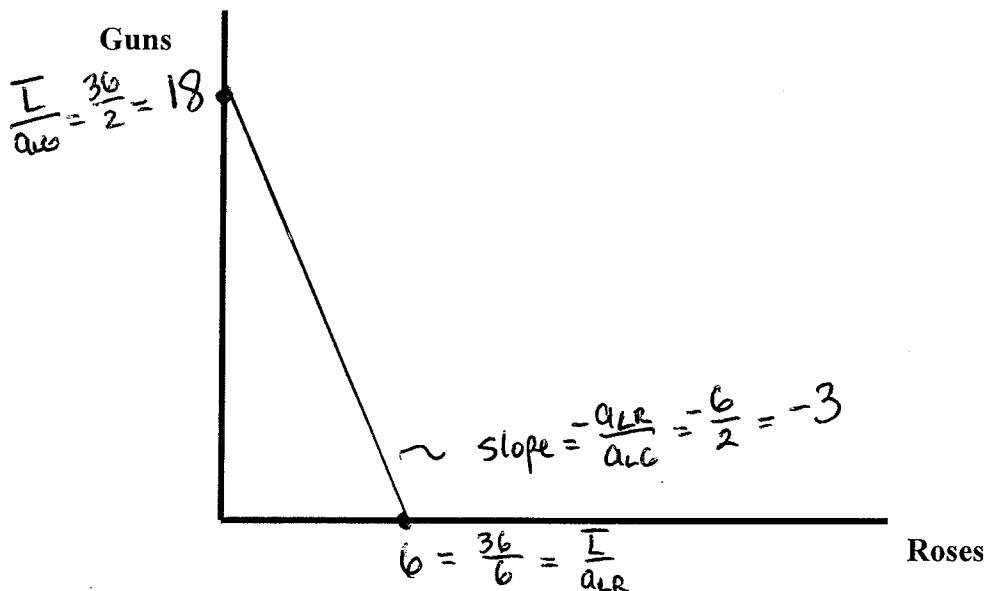
6) Which country has the comparative advantage in GUNS and why?

Neither country because both face the same internal autarky prices

In TW, 1 Gun costs $\frac{1}{3}$ ($\frac{2}{6}$) Roses

Likewise in LC, 1 Gun costs $\frac{1}{3}$ ($\frac{5}{15}$) Roses

7) Suppose that Teenage Wasteland (TW) has 36 units of labor for production. On the set of axis, below draw TW's PPF, using calculations based on the information in this question and in question 6 above to get exact numbers for the intercepts on each axis and for the slope of the PPF.



8) Suppose that Land of Confusion discovers a new technology to reduce production time for Roses from 15 units of labor to 10 units of labor. Which country now has the comparative advantage in GUNS and why?

Now in LC, 1 Gun costs $\frac{1}{2}$ ($\frac{5}{10}$) Roses, whereas as the price of Guns in TW remains at $\frac{1}{3}$ Roses. Since TW now has a lower internal price (opportunity cost) of producing Guns, they have the comparative advantage in Guns.
(TW)