

ECON 305
INTERNATIONAL ECONOMICS I
Dr. Yetkiner

15 October 2007

Exercise 03
Extensions of the Classical Model of Trade

1. The following table shows the hours of labor required to produce one unit of each commodity in each country:

	Cloth (yards)	Wine (gallons)	Shoes (pairs)
England	2 hrs	3 hrs	2 hrs
Portugal	1 hr	3 hrs	5 hrs

Suppose that wage rates are £1 and €0.5 in England and Portugal, respectively. Suppose also that exchange rate is £1=€1.

a. Is there a basis for trade? **Show.**

b. Suppose that the wage rate in England increased to £2. How is the pattern-of-trade affected from this change (is there a basis for trade anymore)?

c. Suppose that the exchange rate becomes to £1=€0.5 in (a). How is the pattern-of-trade affected from this change?

d. Suppose now that **transportation cost**, equivalent to **1 labor hour**, is charged (added to the selling price) by the exporter, and paid by the importer. How would that change the pattern-of-trade in (a)?

2. The following table shows the hours of labor required to produce one unit of each commodity in each country:

	Cloth (hours/yard)	Wine (hours/Gallon)
England	2	2
Portugal	1	5

Suppose that wage rates are £1 and €0.5 in England and in Portugal, respectively. Suppose also that exchange rate is £1=€1.

a. Find the wage rate limits of England and Portugal.

b. Determine the exchange rate limits.