

Hand-out week 2

This week:

1. Classical Trade Theory (cont'd)
 - 1.2. the Heckscher–Ohlin model: the 2x2x2 setup, Stolper–Samuelson, factor price equalization, Heckscher–Ohlin, Rybczynski, empirical evidence.
 - 1.3. the specific factors model: setup and distributional effects of trade.

Readings: Krugman&Obstfeld, chpts 5, 4, 3.

Practice problems:

1. State the Stolper–Samuelson result. Why do we speak of a magnification effect? Show this effect graphically. Now, if one uses the result to explain the increasing wage inequality between skilled and unskilled labor in the U.S., what would be the prediction for our trading partner, say Mexico?
2. K&O problem 4.5.
3. Suppose the U.S. has 40 machines and 200 workers while Canada has only 10 machines and 60 workers. Suppose further that for some given relative factor price one unit of steel requires two machines and eight workers whereas a unit of lumber is produced using one machine and eight workers. Which country is labor abundant, which country capital abundant? Which good is capital intensive, which good labor intensive? Which country will export lumber, which country steel?
4. K&O problem 4.2.
5. State the Heckscher–Ohlin result. If you wanted to test it, which are the three things you would need to determine about a country and its trade. Given the somewhat unsatisfactory history of such tests, name possible reasons for the discrepancy between the theory and reality.