

Sensorveiledning/Assessment Guidelines

1) Absolute and Comparative Advantage in the Ricardian Model

This exercise requires an understanding of the concepts of absolute- and comparative advantage and its application to numerical examples under the restrictive assumptions of the Ricardian Model, and an understanding that comparative advantage with its emphasis on differences in relative productivity patterns between the countries is a determinant of the patterns of trade.

It is important that students back up their conclusions with precise analysis. It is also desirable that students first present the situation with the use of general expressions before substituting numerical values.

With regard to presentation: Students should explain the meaning of all symbols they use, unless that is already given in the exercise text.

- a) Country B has an absolute advantage in producing wine
- b) Country B has also an absolute advantage in producing cheese.
- c) Country A has a comparative advantage in producing wine.
- d) Country B has a comparative advantage in producing cheese.
- e) In a closed economy a country can consume only what it produces itself. So, under the assumption that none of the product is wasted, destroyed or thrown away, the quantity consumed is equal to the quantity produced : 1 500 000 kilos of cheese and 1 000 000 bottles of wine.
- f) According to the Ricardian Model and assuming that all conditions of the Ricardian Model are satisfied, a country will export the good in whose production it has a comparative advantage, and (in a 2 country 2 good world) import the other good.

So, in our case, after international trade opens up, country A will export wine and import cheese, and country B will export cheese and import wine. (by part b and c above).

2) Relative Prices and Gains from Trade in the Ricardian Model.

This exercise continues the 'story' of exercise 1, but with a focus on relative prices before and after trade opens up, and on how to precisely show the gains from trade for both countries. This requires a demonstration of understanding of concepts, the use of those concepts in analysis, accurate calculation and interpretation of results. To get full credit numerical demonstration of the gains from trade is required. As before, students should explain the meaning of all the symbols they use, unless they have already been defined in the exercise text, or in the solution to exercise 1.

It is important that students back up their conclusions with precise analysis. It is also desirable that students first present the situation with the use of general expressions before substituting numerical values.

a) When country A allocates all labor hours to the production of wine, it produces 2 million bottles of wine.

b) When country A allocates all its labor hours to cheese production it produces 3 million kilos of cheese.

c) When country B allocates all its labor hours into wine production of wine it produces 2 million bottles of wine.

d) When country B allocates all its labor hours into cheese production it produces 5 million kilos of cheese.

e) Country A

The relative price of wine is 1.50 units of cheese.

The relative price of cheese is 0.67 units of wine.

Country B

The relative price of wine is 2.5 units of cheese.

The relative price of cheese is 0.4 units of wine.

f) Country A

Via producing cheese itself 10 labor hours get country A one kilo of cheese.

Via specializing in wine production and getting cheese through trade these 10 labor hours get country A 1.34 kilos of cheese at the given world relative prices. This is a gain of 0.34 kilos of cheese for every 10 hours of labor. This is the gain from trade for country A.

Country B

Via home production of wine, 10 labor hours get country B 1 bottle of wine. Via specialization in cheese production and getting wine through trade these 10 labor hours generate 1.25 bottles of wine. This is a gain of 0.25 bottles of wine for every 10 hours of labor. This is the gain from trade for country B.

3) Specific Factors, Income Distribution and International Labor Migration

This exercise highlights differences between factors of production along the line of 'mobile' or 'non-mobile', effects of labor migration and, and the concepts from Microeconomics that workers are paid their marginal product, and that, other things constant, diminishing marginal productivity.

It is important that students' answers refer to the given numerical table which demonstrates diminishing marginal productivity of factor labor, given that the factor land is fixed and non-mobile. A complete solution will not only correctly state the direction of changes, but also the numerical values of the changes.

- a) Wages increase for the three workers that migrate from Bulgaria to UK from $w_B = 21$ to $w_{UK} = 25$.
- b) Wages increase for the workers who remain in Bulgaria from $w_B = 21$ to $w_B = 24$.
- c) Wages decrease for workers originally in the UK from $w_{UK} = 28$ to $w_{UK} = 25$.
- d) Operating costs in Bulgaria increase for landowners because they have to pay higher wages (see b)
- e) Operating costs in UK decline for landowners because the wages that they pay to the workers have declined (see c).
- f) Wages for the 3 return migrants decline from $w_{UK} = 25$ to $w_B = 20$. (This assumes that the 4th migrant from UK moves simultaneously with the 3 return migrants and that there has been no discrimination in wages against foreigners).
- g) The wage of the British worker who migrates to Bulgaria follows the same path as that of the three return migrants. The wage declines from $w_{UK} = 25$ to $w_B = 20$.
- h) Wages of workers who remain in the UK increase from $w_{UK} = 25$ to $w_{UK} = 29$.
- i) Wages decline for workers who had always been in Bulgaria from $w_B = 24$ to $w_B = 20$.
- j) Operating costs decline for landowners in Bulgaria because of the decline in wages that they pay to workers. (see (i) and (g)).
- k) Operating costs increase for landowners in UK because of the increase in wages that they pay to their workers (see (h)).

b) This is an extreme case of Interest Rate Parity NOT holding, with a large opportunity for arbitrage. A complete answer consists of an explanation of the concept of interest rate parity and a demonstration of why in this case IRP is not satisfied.

4) Firms in the Global Economy

Here any well explained and clearly presented rendition of advantages and disadvantages of globalization/de-globalization are acceptable.

A recommendation for policy/action must be part of the answer.