

### Question for Chapter 3

(1) The Ricardian Model.

	Cheese	Wine
Home	$a_{LC} = 1/2$	$a_{LW} = 1$
Foreign	$a_{LC}^* = 1/4$	$a_{LW}^* = 1/5$

The above grid indicates the unit labor requirements for cheese and wine at home and abroad. Assume that each country has 40 hours of labor.

- Describe the production advantages of each country. What are the pre-trade prices in the two countries and how do they reflect opportunity costs?
- Assume the world price of cheese relative to wine is 1 when trade opens. What happens to trade if the price is 0.5 instead of 1 on world markets?
- Illustrate the pre-trade prices and world price of 1 using a relative supply and demand diagram. Explain the shape of the relative supply (of cheese to wine) curve.
- Show the gains from trade graphically, for each country, when the world price of cheese relative to wine is 1.
- How are the wage rates impacted in each country by the opening of trade?