

## Questions for Chapter 4 (SFM)

(1) Assume that a country produces two goods: manufactures and food. Manufactures are produced with capital and labor and food is produced with land and labor. Suppose that poor weather reduces crop yields, which leads to a 10 percent rise in the price of food.

(a) Use a diagram to illustrate the effect on the labor demand curves for food and manufactured goods.

(b) What is the impact on wages?

(c) How does the distribution of labor across sectors change? How does the output of each sector change?

(d) How does the change in relative prices affect the economy's production mix? Demonstrate this impact graphically on a PPF.

(e) How does the decline in  $P_m$  relative to the  $P_f$  affect the income distribution across capitalists and landowners?

(f) What can be said about the impact on the earnings of workers? Assume that manufactures account for the largest portion of a worker's consumption basket.

(2) Assume that a country produces two goods: manufactures and food. Manufactures are produced with capital and labor and food is produced with land and labor. Suppose there is an increase in the country's endowment of capital without any change in its labor or land endowment. Explain and illustrate the impact of this endowment change on the mix of output and the income distribution within this country. Your explanation should include a diagram for the labor market and a relative supply and demand diagram.