Questions for PubPol/Econ 541
Nov 1

Behind the Standard Model

KOM, Ch 3, selected pages:

- "To produce more of one good, the economy must sacrifice some production of another good." Is this always true? What if there is unemployment? **<a: That depends on whether it is possible to reduce unemployment on a sustainable basis. In a recession, that is possible, and then the statement is not true; one could in principle increase output of one without reducing output of another. The production possibility frontier (or rather, being on it) assumes that there is no removable unemployment.>**
- What do the relative supply and demand curves of a country look like in the Ricardian Model, and why? What do they look like for the world of two countries? **<a: For one country, relative supply is zero up to its autarky price, horizontal at that price out to infinity. For the world, it is zero up to the lower autarky price, horizontal out to the ratio of maximum amounts that the two countries can produce of their comparative-advantage goods where it become vertical, and then horizontal out to infinity at the higher autarky price. Relative demands are downward sloping the same as in the Standard Model.>**
- Suppose that preferences change so that, at given prices, demanders everywhere increase their preferred consumption of one good and decrease it for the other. In most models, such a change will cause both the price and the quantity of the preferred good to increase. Is that true in the Ricardian Model, of a closed economy and/or of a two-country world? **<a: No. In a closed economy quantity rises but price does not change. In a two-country world, either price or quantity will increase, but not both, the answer depending on whether one or both countries are completely specialized.>**
- In the Ricardian Model, do both countries necessarily gain from trade? Is it possible for a country to lose from trade? **<a: They don't both necessarily gain, since if one country is large enough that it produces both goods when there is trade, then it neither gains nor loses. But no country can lose from trade.>**
- Does comparative advantage imply absolute advantage? Does absolute advantage imply comparative advantage? **<a: No to both. A country can have comparative advantage in a good in which it has absolute disadvantage, and indeed it must if it has absolute disadvantage in both goods. And a country can have comparative disadvantage in a good with absolute advantage, and indeed it must if it has absolute advantage in both goods. (In both cases, unless the ratios are exactly the same.)>**
- If the wage rate in a country falls due to trade, do workers lose from trade? **<a: If it is the nominal wage that falls, then workers need not lose if the prices of all goods fall at least as much.>**

KOM, Ch 5, selected pages:

- If one country has more of both capital and labor than the other country, what will it export? **<a: That depends on the ratio of the factor endowments, not their absolute levels. It will export the good that uses intensively the factor that it has relatively more of.>**
- Is the Heckscher-Ohlin Theorem, as a theory of trade, an alternative to the theory of comparative advantage? **<a: No. It is one of several explanations of comparative advantage.>**
- Who gains and who loses from trade, in the two-factor model? **<a: Owners of abundant factors gain and owners of scarce factors lose.>**
- How have the wages of skilled and unskilled labor in the US changed since the 1970s? Could this change be due to trade? Is it in fact due primarily to trade? **<a: Wages of skilled workers rose relative to unskilled workers, and this would be consistent with the implications of the HO model given that unskilled labor is scarce in the US. But evidence suggests that the change in relative wages was due only partly to trade, but more due to technology.>**
- In what sense can trade in goods be regarded as equivalent to trade in (or international movement of) factors? **<a: The goods can be thought of as embodying the services of the factors.>**
- What are some of the reasons why the prediction of international factor price equalization does not hold in the real world? **<a: 1) Technologies are not the same across countries. 2) Trade is not free – there are costs of trade. 3) Countries do not produce the same goods; there is specialization.>**

Deardorff, "Introduction to Comparative Advantage," 2003.

- Why is comparative advantage a relative concept in two senses simultaneously? **<a: Because the comparison is both across goods and across countries.>**
- How can one identify comparative advantage in terms of
    - Unit labor requirements for producing goods? **<a: Find the good whose unit labor requirement, divided by the unit labor requirement for the other good, is lower than that ratio in the other country.>**
    - Output per worker in producing the goods? **<a: Find the good whose output per worker, divided by the output per worker for the other good, is higher than that ratio in the other country.>**
    - Opportunity cost? **<a: Find the good with the lower opportunity cost in terms of the amount of the other good that must be given up in order to produce it.>**
- When a high-wage country trades with a low-wage country in the Ricardian model, who is hurt, or hurt more: The high-wage workers or the low-wage workers? **<a: Neither is hurt. At worst, workers in the country that is larger (regardless of whether their wage is high or low) are made neither better nor worse off, if the country continues to produce both goods with trade.>**

Freeman, "Are Your Wages Set in Beijing?" 1995.

- What happened to wages in the US, starting in the 1980s, that prompted the literature that Freeman reviews in his article "Are Your Wages Set in Beijing?"? **<a: Wages of skilled (or educated) workers rose faster than the wages of less skilled (or less educated) workers, and wages of the less skilled actually declined.>**
- Contrast the changes in skilled and unskilled wages and employment in the U.S. and Europe. **<a: In the US: Greater earnings differentials by education, by age, by skill, both overall and within demographic groups; absolute decline in real wages of low skilled: 20% or 30% since 1979. In Europe: Increased unemployment for the same low-skilled groups (but not the fall in wages).>**
- Why is it plausible that international trade might be the cause of these changes? **<a: Both empirically, because the role of trade with LDCs has grown, and theoretically because basic trade theory says this should happen>**
- What do studies generally say about whether in fact international trade is responsible for these changes? **<a: Trade is a part of the cause, but not the largest part.>**
- By what mechanism can it be argued that globalization could lead to the observed changes in wages that began in the 1980s? **<a: The Stolper-Samuelson Theorem would predict exactly that for the US if skilled labor is our abundant factor and if during the 1980s trade barriers were falling.>**
- Two empirical approaches to studying the effects of globalization are described by Freeman, one looking at the "factor content of trade" and the other looking at prices. What is the reasoning behind each? **<a: The factor content of trade treats exports as reducing the available supply of those factors used to produce exports, and treats imports as increasing the available supply of those factors used to produce imports, so that a raise in skilled wages can be inferred from the increased scarcity of skilled labor and reduced scarcity of unskilled labor. The price approach infers wages from prices, a la the Stolper-Samuelson Theorem.>**