**NAME:** ________________________________________________________________

**International Trade**  
**Fall 2005**  
**Quiz 2**

*HOME* and *FOREIGN* produce and consume two goods, *Juice* and *Steak*, using (amazingly) only labor as a factor of production. Labor supply is 200 in *HOME* and 200 in *FOREIGN*. Unit labor requirements are as follows:

<table>
<thead>
<tr>
<th></th>
<th>STEAK</th>
<th>JUICE</th>
</tr>
</thead>
<tbody>
<tr>
<td>HOME</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>FOREIGN</td>
<td>2</td>
<td>4</td>
</tr>
</tbody>
</table>

1. (4 points) Draw the RS curve on the axes at the right, filling in all three spaces with numbers based on the unit labor requirements given in the Table. You must fill in numbers: algebraic formulas will not receive any credit.

   1 point each for filling in the boxes, and one point for drawing the RS curve.

2. (1 point) Suppose that at the *free-trade equilibrium*, the world (*HOME* + *FOREIGN*) consumes 120 Steaks and 120 bottles of Juice. Draw a Relative Demand (RD) Curve in the graph that is consistent with these demands. In equilibrium, \( RD = \frac{120}{120} = 1 \). **This is less than** \( \frac{200}{100} = 2 \), so for this to be an equilibrium it has to be the case that the RD curve intersects RS in the lower horizontal segment (at \( \frac{(Q_J+Q_J^*)}{(Q_S+Q_S^*)} = 1 \)).

3. (1 point) At this equilibrium, *HOME* exports (please choose the best answer):
   - a. Steak
   - b. *Juice*
   - c. Neither Steak nor Juice. *HOME* remains in autarky and produces only what it consumes.

   **HOME sells Juice to FOREIGN, because FOREIGN wants to consume Juice, but specializes in producing Steak.**
4. (2 points) The graphs below show PPFs and consumption opportunity lines for HOME and FOREIGN. In these graphs, a large dot indicates the country’s production point, and a heart indicates its consumption point. Which set could be consistent with the equilibrium you drew in question 2? Please choose one of the following: A b. B c. C d. None of the graphs could be consistent

The equilibrium price is HOME’s opportunity cost of Juice. HOME sells some Juice to FOREIGN, and so consumes less Juice than it produces. These two things happen only in graph B.

5. (2 points) Mexico and the United States produce Olive Oil and Textiles. The marginal product of labor in the Olive Oil industry is equal to 2 in the United States and to 4 in Mexico. This is enough information for us to conclude that

a. The United States has the comparative advantage in producing Olive Oil.
b. Mexico has the comparative advantage in producing Olive Oil.
c. The United States has the absolute advantage in producing Olive Oil.
d. Mexico has the absolute advantage in producing Olive Oil.