INTERNATIONAL TRADE
Theory of ABSOLUTE ADVANTAGE

A

ASSUMPTIONS OF THE MODEL:

1   ALL FIRMS HAVE CONSTANT RETURNS TO SCALE AS OUTPUT CHANGES
2   PERFECT FACTOR MOBILITY WITHIN THE COUNTRY
3   NO TRANSPORT COSTS IN INTERNATIONAL TRADE
4   PERFECT COMPETITION EXISTS IN PRODUCT AND FACTOR MARKETS.
5   NO BARRIERS TO TRADE SUCH AS TARIFFS OR QUOTAS

Task 1:
Cauculate opportunity cost of:

1. 1 car (uk)
2. 1 car (por)
3. 1 wheat (uk)
4. 1wheat (por)

What are the costs for each country to produce wheat + cars?

Calculate opportunity cost values.

NO TRADE (10 x on each)

UNITS OF OUTPUT PRODUCED WITHOUT SPECIALISATION: UK AND PORTUGAL

B

KILOS OF WHEAT   **NO OF CARS**

	KILOS OF WHEAT	NO OF CARS
UK	100	50
POR	200	40
TOTAL	300	90

TRADE 20 x on each

UNITS OF OUTPUT PRODUCED WITH SPECIALISATION,UK AND PORTUGAL:

D

KILOS OF WHEAT   **NO OF CARS**

	KILOS OF WHEAT	NO OF CARS
UK	0	100
POR	400	0
TOTAL	400	100

C

PRODUCTION POSSIBILITIES FOR WHEAT AND CARS,UK AND PORTUGAL:

	KILOS OF WHEAT PER X RESOURCES	NO OF CARS PER X RESOURCES
UK	10 (2)	5(.5)
POR	20 (5)	4(.2)

Key
UK: 1 w = .5 cars; 1c = 2 wheat
Por: 1w = .2 cars; 1c = 5 wheat
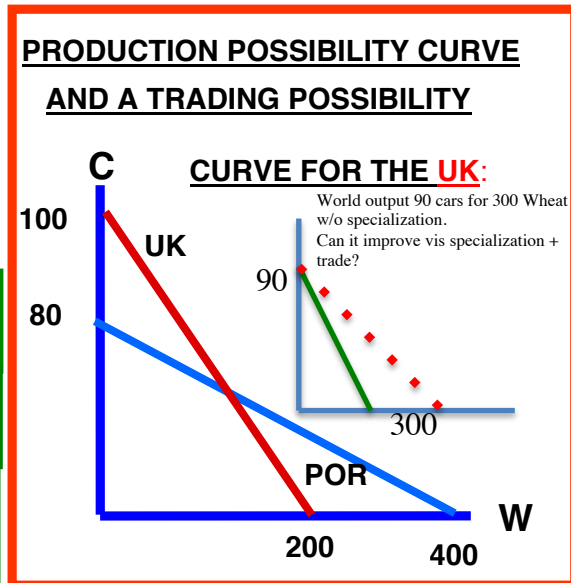
NOTE: ASSUME EACH COUNTRY HAS 20 X OF RESOURCES

Key words:
opportunity cost + absolute advantage

Task 2: Find an exchange rate which works for both countries. Use Opportunity Cost to guide you. E.g 1 car = 6 wheat???

Trade Rates: (based on O. C. values
UK: 1 car > 2 wheat.
Por: 1 wheat > 0.2 cars.

PRODUCTION POSSIBILITY CURVE AND A TRADING POSSIBILITY CURVE FOR THE UK:

World output 90 cars for 300 Wheat w/o specialization.
Can it improve vis specialization + trade?

What exchange rate would work so both nations benefit? How abour 1 UK car for 4.5 wheat. Then UK gets 450 (200) wheat. Por. Gets 88.88 (80) cars. Specialisation +t rade works!