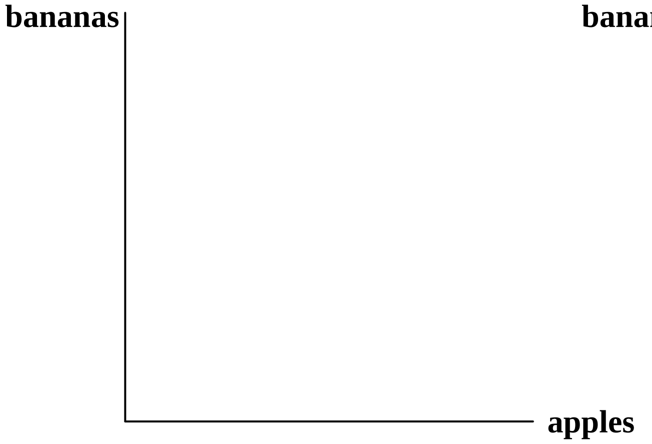
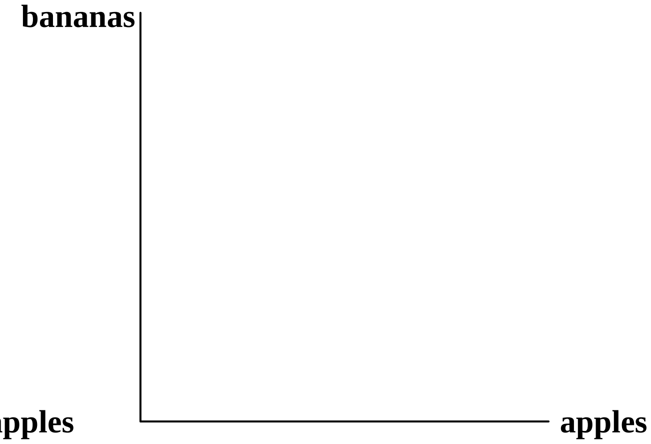
International Trade in Services **Exercise 1** **Name:**

1. Country A has 1200 units of labor available. It can produce two goods, apples and bananas. The unit labor requirement in apple production is 3, while in banana production it is 2.

A. Draw country A's production possibility frontier.

Country A **Country B**





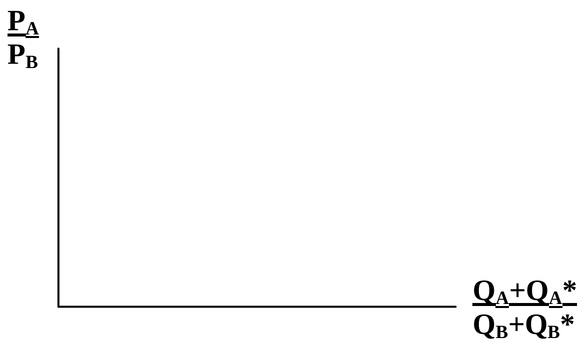
B. What is the opportunity cost of apples in terms of bananas?

C. In the absence of trade, what would the price of apples in terms of bananas be?

Country B has a labor force of 800. Country B's unit labor requirement in apple production is 5, while in banana production is 1.

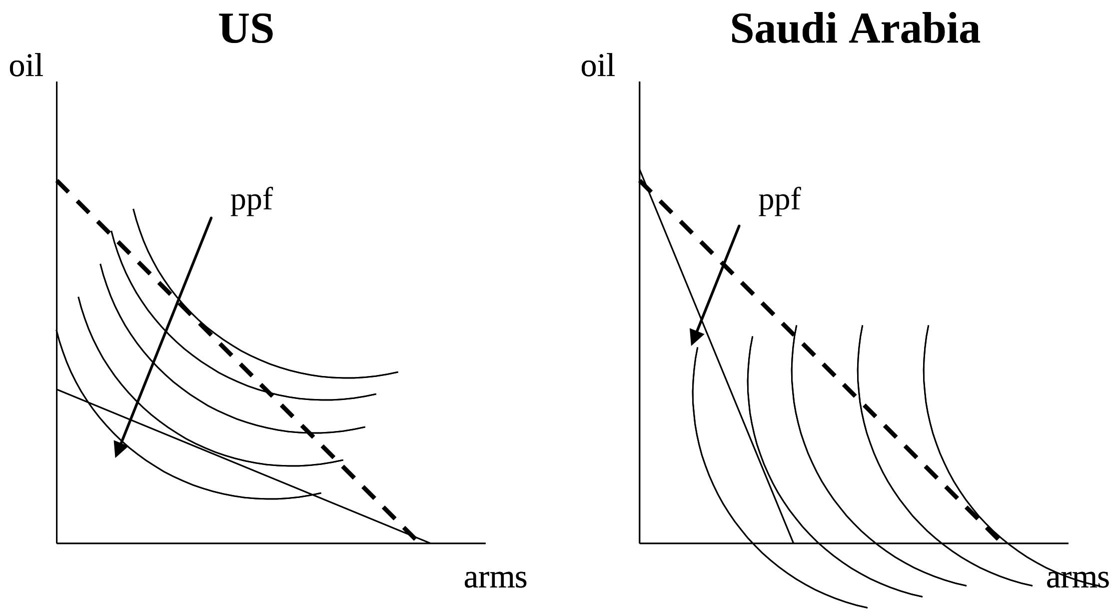
D. Draw country B's production possibility frontier. What is the opportunity cost of apples in terms of bananas?

E. Describe the pattern of trade by constructing the world relative supply curves before and after trade. What is the relative quantity of apples supplied in the world in case of specialization?



F. Show numerically (using the concept of indirect production) and graphically (above) how both countries gain from trade if the world relative price of apples in terms of bananas becomes 3 after trade.

International Trade in Services **Exercise 1** **Name:**



US and Saudi Arabia are the only producers of oil and arms in this world. The only factor of production is capital and it can be used to producer either of the goods. The solid line is the relative price of arms in terms of oil in each of the two countries in Autarky (before trade). The dotted line is this price in both countries (the world relative price of arms in terms of oil) after trade. The indifference curves of the citizens in each country is also drawn.

Explain the above graph. Concentrate on

a. What is US more productive in producing? And Saudi Arabia?

b. What do the preferences of citizens in each country look like with respect to oil and arms?

c. Where is production in each country prior to trade? (point out in graph)

d. Where is consumption in each country prior to trade? (point out in graph)

e. What happens to the world relative price of arms in US after trade? and in Saudi Arabia?

f. What happens to the world relative price of oil in US after trade? and in Saudi Arabia?

g. Are there gains for US and/or Saudi Arabia from the international trade of oil for arms? Why?

h. Where is production of the two goods be in each country after trade? (point out in graph)

i. Where is consumption of the two goods be in each country after trade? (point out in graph)

j. What does US export? What does it import? Show the amount in graph. (think about excess supply/excess demand).

k. What does Saudi Arabia export? What does it import? Show the amount in graph. (think about excess supply/excess demand).