Week 2 Handout Solutions

Exercise 1:

$X^A = 8 > 6 = X^B$ so A has Absolute Advantage in X

$Y^A = 4 > 2 = Y^B$ so A has Abs. Advantage in Y

$\frac{X^A}{Y^A} = 2$ $\quad \frac{X^B}{Y^B} = 3$ so B has Comparative advantage in X

$\frac{Y^A}{X^A} = \frac{1}{2}$ $\quad \frac{Y^B}{X^B} = \frac{1}{3}$ so A has Comparative advantage in Y

Exercise 2:

Initially: $(X^A, Y^A) = (4, 2)$

$(X^B, Y^B = (3, 1)$

A has CA in X
B has CA in Y
$\Rightarrow$ B should produce more X, A should produce more Y

Let B produce only X. Let A produce 2 of X and 3 of Y.

Total Output $= (X^A + X^B, Y^A + Y^B) = (2+6, 3+0) = (8, 3)$

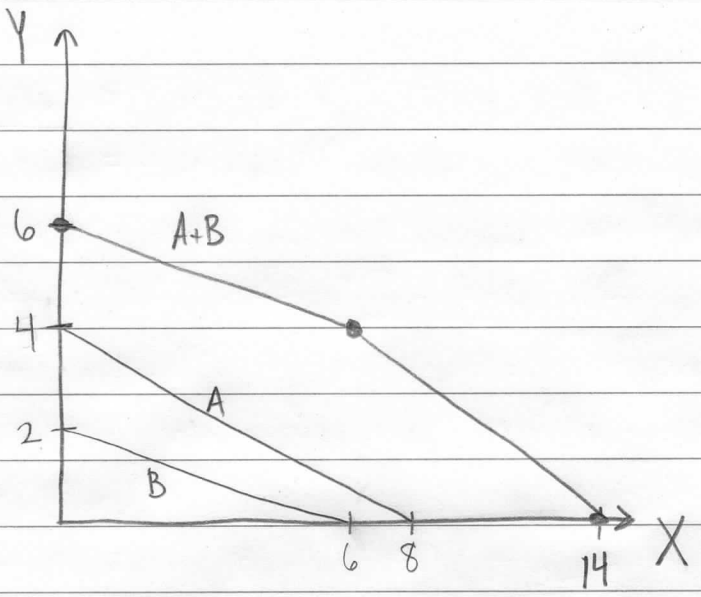
Then, it's possible to divide output so that

$(X^A, Y^A) = (4.5, 2)$

$(X^B, Y^B) = (3.5, 1)$

Both countries get ½ unit more of X so they're both better off.

Exercise 3:



Exercise 4/5: