Liberty High School

DL Economics

Mr. Lopez

Study Guide #6

Gains from Trade

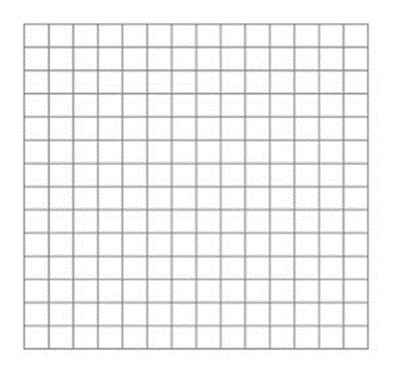
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Part 1 – Key Terms

1. Absolute Advantage:
2. Opportunity Cost:
3. Comparative Advantage:
4. Gains from trade:
5. Imports:
6. Exports:
7. Specialization:
8. Market:

Part 2 – Problems and Short Answers:

1. Why do people trade/shop?
2. What is the purpose of markets?
3. What are some examples of markets?
4. Carlos is a college student. He takes a full load of classes and has only 5 hours per week for his hobby. Carlos can make two clay pots per hour or 4 coffee mugs per hour.
   1. On the graph below, draw Carlos’s production possibilities frontier for pots and mugs.

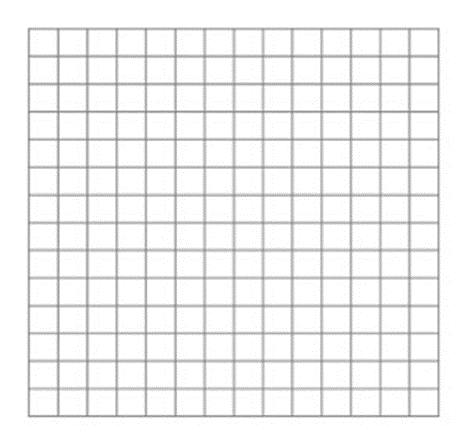


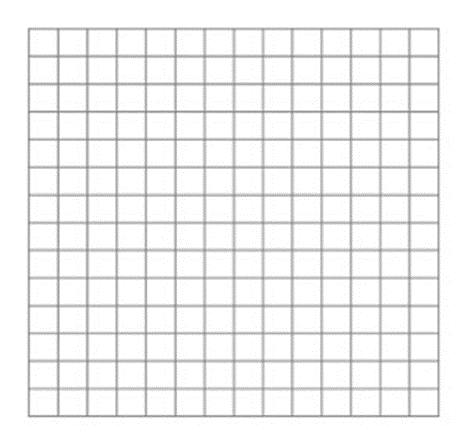
* 1. What is Carlos’s opportunity cost of 1 pot? 10 pots?
  2. What is Carlos’s opportunity cost of 1 mug? 10 mugs?
  3. Why is Carlos’s production possibility frontier a straight line instead of bowed out like some of the one we have graphed to date?

1. Suppose a worker in Germany can produce 15 computers or 5 tons of grain per month. Suppose a worker in Poland can produce 4 computers or 4 tons of grain perm month. Assuming each country has only this one worker.
   1. Complete the following table:

|  |  |  |
| --- | --- | --- |
|  | **Computers** | **Grain** |
| **Germany** |  |  |
| **Poland** |  |  |

* 1. On the graphs below graph the production possibilities frontier for each country. Be sure to label your graphs properly identifying the country, its two options, and its x and y numbers.





* 1. What is the opportunity cost of 1 computer in Germany? What is the opportunity cost of 1 ton of grain in Germany?
  2. What is the opportunity cost of 1 computer in Poland? What is the opportunity cost of 1 ton of grain in Poland?
  3. Which of these countries has an absolute advantage in producing computers? Grain?
  4. Which country has the comparative advantage in producing computers? Grain?
  5. What should each of these nations specialize in and why?
  6. What is the range of prices for computers and grain for which both nations would benefit?
  7. Suppose the nations agree on a price of 2 computers for 1 ton of grain or ½ ton of grain per computer. Suppose each country specializes in production and they grade 4 computers for 2 tons of grain. Plot the final consumption on the graphs that you made above. Are these countries consuming inside or outside their production possibilities frontier?
  8. Suppose the productivity of a worker in Poland doubles so that a worker can produce 8 computers or 8 tons of grain per month. Which country has the absolute advantage in producing computers? Grain?
  9. After the doubling of productivity in Poland, which country has a comparative advantage in producing computers? Grain? Has the comparative advantage changed? Has the material welfare of either country changed?
  10. How would your analysis change if you assumed that each country had 10 million workers?