

Lecture #2
EEP C181/Economics /C181
International Trade
The Ricardian Model

I. Production Possibility Frontiers (PPF) and opportunity cost.

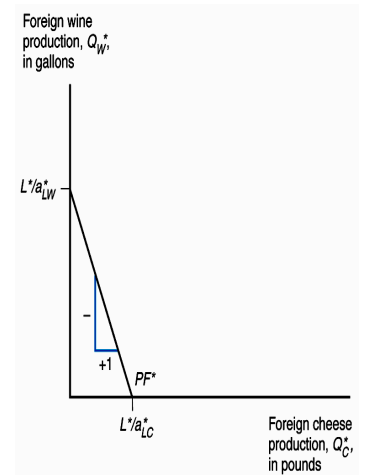
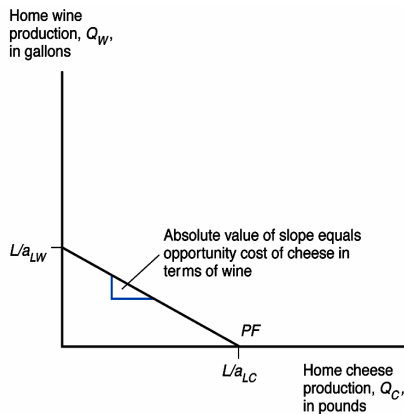
Recall the example from last class:

Two countries: Home (USA) and Foreign (France). Two goods: wine and cheese.

Unit labor requirements (ULR): number of labor hours needed to produce one unit of wine or Cheese

Hours to Produce 1 pound of Cheese or 1 gallon of wine		Total Labor Force (Billion Hours)
Cheese	Wine	
Home (USA) $a_c = 1$	$a_w = 2$	120
Foreign (France) $a_c^* = 6$	$a_w^* = 3$	60

We can use these ULR's to derive production possibility frontier (PPFs):



Defining Opportunity Cost: The Opportunity cost of a pound of cheese in terms of wine is the number of gallons of wine that an economy would have to give up to produce an extra pound of cheese. Equal to a_c/a_w , which is the absolute value of the slope of the PPF.

II. Relative prices and trade.

- Autarky prices (means prices before trade) equal to opportunity cost of cheese in terms of wine.
- There will be gains from trade as long as autarky prices in two countries are not equal.
- In other words, there will be gains from trade as long as two slopes are not equal.
- In our example, USA has comparative advantage in producing cheese, France in wine.
- Traded price will fall between $\frac{1}{2}$ and 2.
- USA will export cheese, France will export wine.

