

# HOMEWORK 1

ECN 201, Spring 2001  
 Prof. Bruce Blonigen

Due: Beginning of discussion sections  
 in week 2 of the quarter.

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The following example is intended to show you why countries trade goods and benefit from trade. The simple answer is comparative advantage. Countries can specialize their production into the goods in which they have a comparative advantage and then trade for goods in which they are at a comparative disadvantage.

We will make some assumptions to simplify the example. Suppose the world consists of only two countries, Austria and Switzerland. Also, there are just two products that the countries can produce and that their consumers would want to consume, beer and pretzels. We'll assume both countries have identical resources.

The following table shows how much each country can produce of each product in one day if they put all their resources and technology into that particular good. (For example, in one day Austria can produce 10 tons of beer if it puts all its resources into beer production)

	Austria	Switzerland
Beer	10 tons	24 tons
Pretzels	20 tons	20 tons

- 1) Which country has the **absolute** advantage in producing beer? \_\_\_\_\_
- 2) Which country has the **absolute** advantage in producing pretzels? \_\_\_\_\_
- 3) What is Austria's opportunity cost of producing 1 ton of beer? \_\_\_\_\_
- 4) What is Switzerland's opportunity cost of producing 1 ton of beer? \_\_\_\_\_
- 5) What is Austria's opportunity cost of producing 1 ton of pretzels? \_\_\_\_\_
- 6) What is Switzerland's opportunity cost of producing 1 tons of pretzels? \_\_\_\_\_
- 7) Which country has the **comparative** advantage in producing beer? \_\_\_\_\_
- 8) Which country has the **comparative** advantage in producing pretzels? \_\_\_\_\_

9) How many pretzels and beer would be produced by **Austria** if the country spent half its day producing beer and half its day producing pretzels?

Beer: \_\_\_\_\_  
 Pretzels: \_\_\_\_\_

10) How many pretzels and beer would be produced by **Switzerland** if the country spent half its day producing beer and half its day producing pretzels?

Beer: \_\_\_\_\_  
 Pretzels: \_\_\_\_\_

*Turn over for further questions*

**11)** How many pretzels and beer would be produced ***in the world*** (that is, the total across both countries) if each country spent half their day producing beer and half their day producing pretzels?

Beer: \_\_\_\_\_  
Pretzels: \_\_\_\_\_

**12)** How many pretzels and beer would be produced each country and in the world if each country specialized in their comparative advantage?

Austria

Beer: \_\_\_\_\_  
Pretzels: \_\_\_\_\_

Switzerland

Beer: \_\_\_\_\_  
Pretzels: \_\_\_\_\_

World (Both Countries)

Beer: \_\_\_\_\_  
Pretzels: \_\_\_\_\_

**13)** Suppose countries specialized in the product in which they had a comparative advantage as in questions 12, and the countries can trade at the following “price”: 1 pretzel for 1 beer. Explain what trade the countries could make so that they are both better off than if they produce both products each for a half day as in questions 9-11.

Trade: \_\_\_\_\_

Why are they better off?

Austria: \_\_\_\_\_

Switzerland: \_\_\_\_\_