

Gerber Text: Chapter 3

1. Use the information in the table on labor productivities in France and Germany to answer questions a through f.

| | Output per Hour Worked | |
|--------|-------------------------------|----------------|
| | France | Germany |
| Cheese | 2 kilograms | 1 kilogram |
| Cars | 0.25 | 0.5 |

- Which country has an absolute advantage in cheese? In cars?
- What is the relative price of cheese in France if it does not trade? In Germany?
- What is opportunity cost of cheese in France? In Germany?
- Which country has a comparative advantage in cheese? In cars? Explain your answer.
- What are the upper and lower bounds for the trade price of cheese?
- Draw a hypothetical PPC for France and label its slope. Suppose that France follows its comparative advantage in deciding where to produce on its PPC. Label its production point.
If the trade price of cars is 5 kilograms of cheese per car, draw a trade line (CPC) showing how France can gain from trade.

Answers:

- France has the absolute advantage in cheese and Germany in cars. This follows because France's productivity is higher in cheese and Germany's is higher in cars.
- The autarkic relative price of cheese in France is one-eighth car per kilogram; in Germany it is one-half car.
- Opportunity costs are equal to relative prices.
- France has a comparative advantage in cheese because its opportunity cost is lower (one-eighth car versus one-half car in Germany). By the same reasoning, Germany has a comparative advantage in cars.
- The trade price of cheese will settle between one-eighth and one-half car per kilo.
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