

Problem Set 2: Heckscher-Ohlin Model

1. Consider the table below

	Countries	
Factor Endowments	C	D
Labor Force (in millions of workers)	12	30
Capital Stock (in thousands of machines)	48	60

Table 1:

- (a) Which country is relatively capital abundant?
 - (b) Which country is relatively labor abundant?
 - (c) Suppose that good S is capital intensive relative to good T. Which country will have a comparative advantage in the production of good S? Explain.
2. Use a general equilibrium (GE) depiction of trade equilibrium in the Heckscher-Ohlin (HO) model to prove that complete specialization in the production of exports, will in general lower the standard of living of an economy relative to incomplete specialization.
3. Consider the economic environment of the HO model from the lectures. Use a Lerner diagram to show the effects of an increase in the endowment of labor for a country.
4. Using the HO framework with two goods (good 1 and good 2), use a Lerner diagram to show the effects of an increase in the price of good 2 on factor prices and on output.
5. What goes wrong in the Lerner diagram if we have:
 - (a) more goods than factors?
 - (b) more factors than goods?
6. Describe a situation in the Heckscher-Ohlin model by which a country would end up fully specializing in a product. What would have to happen for this to be an optimal outcome (in terms of gains from trade) for the country?