

Problem 1

The following table shows you the unit labor requirements for producing wine and car in the US and France. Assume there is no wage difference between the two countries, and there is no quality difference for the products that both countries produce.

Unit labor requirements		
	Wine	Car
The U.S.	0.5 hour/L	0.1 hour/unit
France	0.8 hour/L	0.2 hour/unit

- a) What's the opportunity cost of producing TEN liters of wine in the US? What's the opportunity cost of producing TEN liters of wine in France? And in which industry does the US enjoy the comparative advantage?
- b) First convert the table above into a table of labor productivity, i.e., instead of expressing the numbers in unit labor requirements, express them in terms of quantity of products that can be produced using 1 labor hour. Then, decide in which industry France enjoys relatively higher labor productivity.
- c) From your answers above, in which industry does the US enjoy the absolute advantage? And briefly explain why the US can benefit from free trade.

Problem 2

The following questions are related to the issue of *trade and inequality*.

The US imports huge amount of goods from China each year. Because labor cost in China is much cheaper (10% of US level, according to 2009 estimate), those imported goods tend to drive down the price of similar products in the US. Let's assume the US has two sectors: high-tech and low-tech, the latter of which is in direct competition with China.

- a) What is the impact of China's imports on relative wages between the two sectors in the US? Explain within the context of Stolper-Samuelson (SS) theorem.
- b) If you were a top US policy maker and your goal is to keep US manufacturing industry strong so that it continues to provide job opportunities for the blue-collar workers at home. Meanwhile, you don't want to resort to protectionist measures because free trade has been advocated by the US for many years, and these measures could potentially invoke a trade war with China and hurt US consumers. What would be your policy recommendation to President of the United States? Elaborate.