

8. THEORIES OF INTERNATIONAL TRADE**ASSIGNMENT SOLUTIONS****PROBLEM NO: 1**

Given, of the island of Madagascar in 2012

Index of Export Prices over the previous year = 15%;

Index of Export Prices (P_x) = 115

Index of Import Prices over the previous year = 7%

Index of Import Prices (P_m) = 107

$$\begin{aligned} \text{Terms of Trade} &= \frac{\text{Index of Export Prices}}{\text{Index of Import Prices}} \times 100 = \frac{P_x}{P_m} \times 100 \\ &= \frac{115}{107} \times 100 = 107.47 \cong 107.5 \end{aligned}$$

PROBLEM NO: 2

a) Productivity of Labour (per hour):

Commodity	Country X	Country Y
Sugar	$\frac{1}{2} = 0.5$ units per hour	$\frac{1}{5} = 0.2$ units per hour
Rice	$\frac{1}{4} = 0.25$ units per hour	$\frac{1}{2.5} = 0.4$ units per hour

- b) Country X has absolute advantage in production of Sugar (0.5 units per hour > 0.2 units per hour) over Country Y
- c) Country Y has absolute advantage in production of Rice (0.4 units per hour > 0.25 units per hour) over Country X

PROBLEM NO: 3

a) The table given in the question can be written in the form of Production per Hour, as under:

Country	Product A	Product B
Country P	$\frac{1}{8} = 0.125$ units per hour	$\frac{1}{9} = 0.11$ units per hour
Country Q	$\frac{1}{12} = 0.083$ units per hour	$\frac{1}{3} = 0.33$ units per hour

- b) Since $0.125 > 0.083$, and $0.11 < 0.33$, each Country has absolute advantage over another Country in one commodity each, the Theory of Absolute Advantage is applicable in this case.
- c) Country P has Absolute Advantage in "A", $0.125 > 0.083$, and Country Q has Absolute Advantage in "B" $0.33 > 0.11$.
- d) If International Trade takes place, Country P will produce "A", and Country Q will produce "B".
- e) Opportunity Cost of each product is under -
- Country P:** 0.125 units of 'A' for 0.11 units of 'B'.
- Country Q:** 0.083 units of 'A' for 0.33 units for 'B'.

PROBLEM NO: 4

Commodity	Country A	Country B
Wheat (quintals/hour)	10	5
Rice (quintals/hour)	5	10

Country A has Absolute Advantage in "Wheat", $10 > 5$, and Country B has Absolute Advantage in "Rice" $10 > 5$. Therefore, conclusively we can say that country A would specialize completely in production of wheat and country B in rice.

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THE END

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