

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 10 points. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type this assignment will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1A) (15 points) Draw three trade indifference curves for the USA. Have the two goods be hats and computers. Hats are labor intensive and cars are capital intensive. The USA is capital abundant. Explain why the trade indifference curves curve the direction you drew them. Which direction makes the USA happier? How can you tell?

B) (15 points) Draw three terms of trade lines on the diagram. Use them and your lines from Part A to draw the offer curve for the USA. Briefly explain what you did. Why does the curve bend towards that axis?

2) (30 points) Draw the offer curve diagram for Canada and Mexico. The two products are clothing and lights. Clothing is labor intensive and Mexico is labor abundant. Briefly explain how you know which offer curve belongs to which country. Add the terms of trade line for free trade. Add two indifference curves, one for each country. Have these indifference curves go through the free trade point. In economics we say a situation is Pareto Optimal if you cannot make one party better off without making the other party worse off. Use the diagram you drew to prove that free trade is Pareto Optimal. Explain your logic.

3) (25 points) Draw the offer curve diagram for two countries which has the offer curves crossing three times. Determine which of the three crossings are stable equilibria. Explain your logic. You can choose the countries and products.

4) (15 points) State the Heckscher-Ohlin Theorem. Explain why it makes sense.