Chapter 2

The Ricardian Model

International Economics

» Begin with hand notes on comparative advantage example.

A look at some evidence

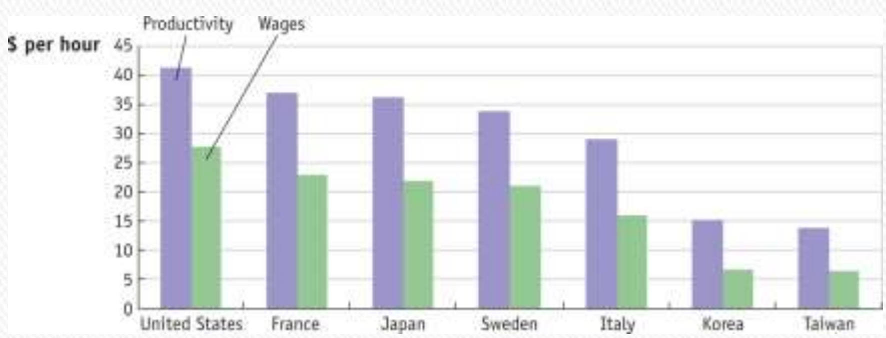
The Ricardian model

	United States	China	Absolute Advantage
	Sales/Employee	*Sales/Employee*	*U.S./China Ratio*
Apparel	$92,000	$13,500	7
Textiles	$140,000	$9,000	16
	Bushels/Hour	*Bushels/Hour*	*U.S./China Ratio*
Wheat	27.5	0.1	275
	Comparative Advantage		
Wheat/apparel ratio × 1,000	0.3	0.01	
Wheat/textile ratio × 1,000	0.2	0.01	

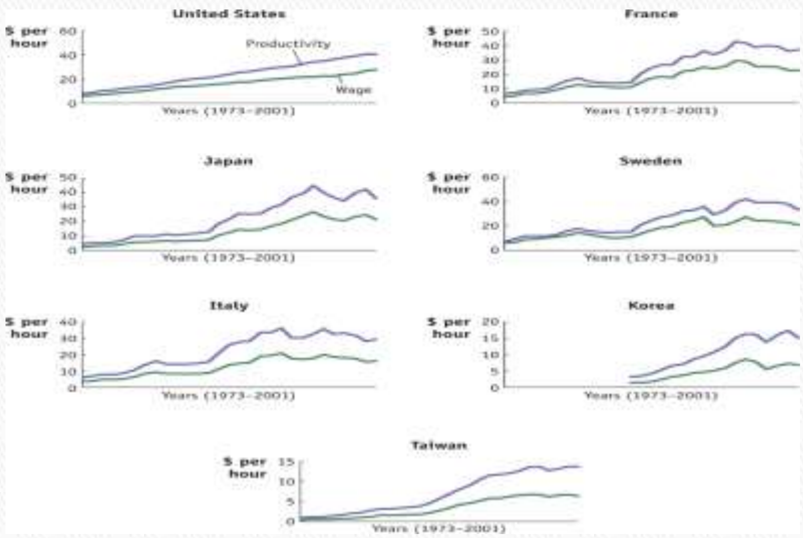
Comparative advantage

» China exports apparels because it has a comparative advantage even though it is much less productive in absolute terms.

Comparative advantage ›



On labor prdtvty and wages ›



On labor prdtvty and wages

- The Ricardian model ignores the role of capital. (That is a problem.)
- Suppose to simplify that all value added comes from labor.
- The following data gives labor productivity (average measure, not marginal).
- It suggests that labor productivity and wages are indeed very closely linked.

On labor prdtvty and wages

» The Prebish-Singer Hypothesis:

Since LDCs export primary products, the terms of trade are evolving against them over time.

Terms of trade

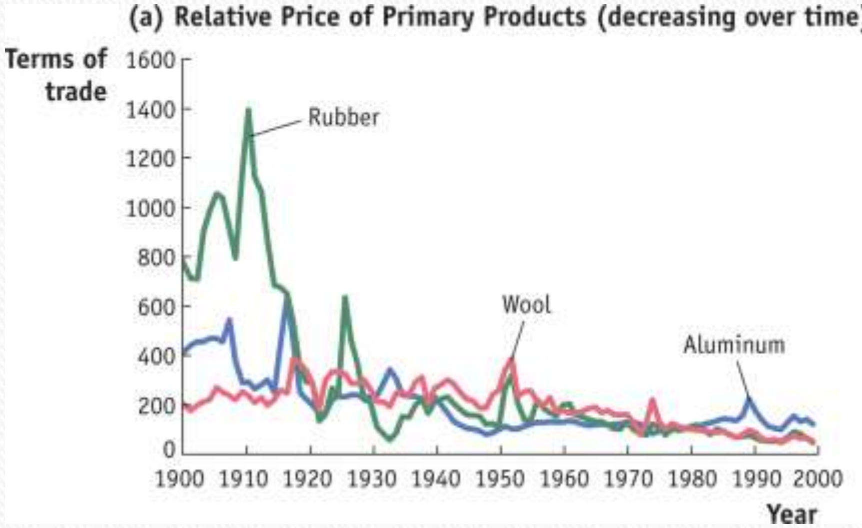
» Arguments:

- As countries become richer, they tend to spend a lower share of income on primary commodities. Hence, the demand for primary commodities decreases relative to that of manufactured goods.
- With new technology, substitutes are found to replace minerals coming from LDCs, thereby lowering their relative prices.

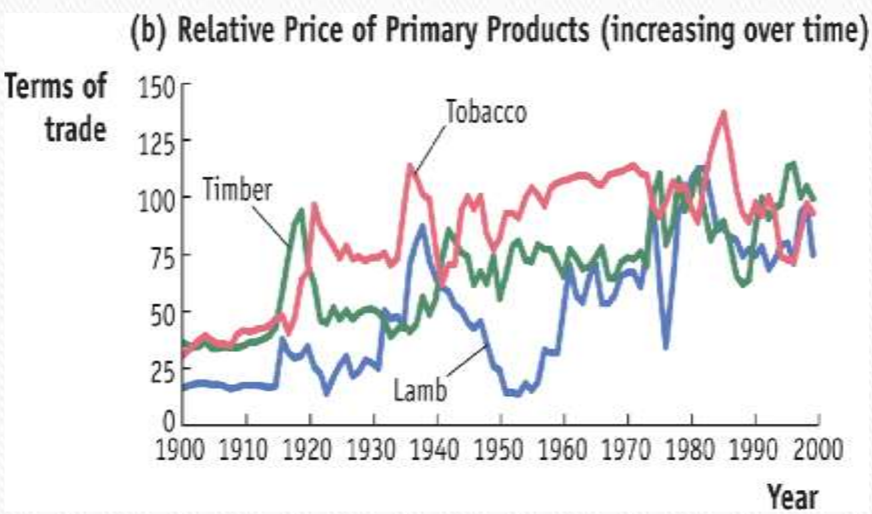
» Counter-arguments:

- Technological progress also leads to cheaper manufactured goods.

Terms of trade



Primary goods prices relative to manufactures



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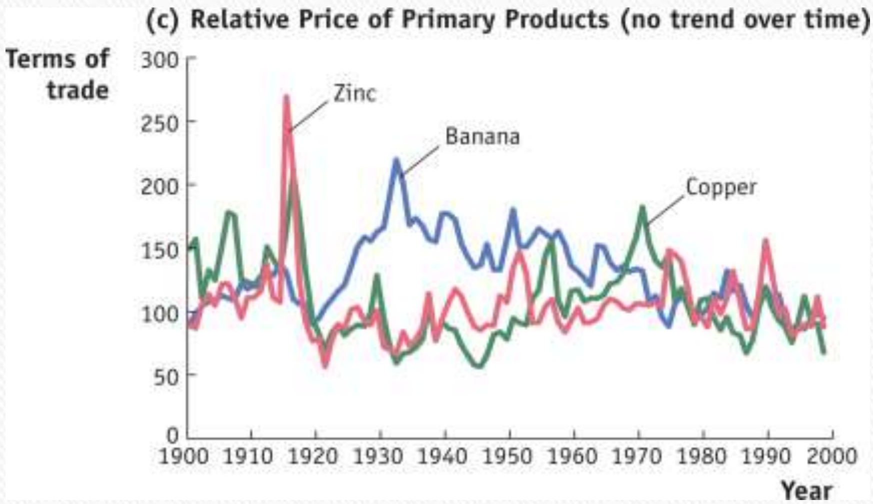

Primary goods prices relative to manufactures

» P56, nos 1,2,3,7.

To do