

Q1- The US can make 60 units of wheat or 120 cars. Canada can make 160 units of wheat or 80 cars.

A- What are the opportunity costs in each nation? Which nation has a comparative advantage in cars? In wheat?

B- Imagine the two nations are not trading with easy other. The US produces and consumes 40 cars and 40 wheat. Canada produce and consumes 40 cars and 80 wheat. What is the total production of cars and wheat?

C- Now suppose each nation specializes and only makes the product for which it has a comparative advantage. What is the new total production of cars and wheat?

D- Next, suppose the US trades 60 units of the good it specializes in to Canada in return for 60 units of the good Canada specializes in. How much more or less can each nation consume compared to the situation in which it did not trade?

Q2- Germany has the following demand for garden gnomes: $P = 200 - Q$ and the following domestic supply of garden gnomes: $P = 50 + Q$.

A. Assume Germany is autarkic (it does not trade with any nation), graph the demand and supply functions and determine the equilibrium price and quantity.

- B. Determine the amount of consumer surplus, producer surplus, and gains to trade.**
- C. Assume Germany can import similar garden gnomes from Poland at a free-trade price of \$50. What is domestic quantity supplied? Domestic quantity demanded? The amount of imports? (Assume Germany is a “small” nation).**
- D. Germany applies a \$50/gnome tariff on Polish made gnomes. What is domestic quantity supplied? Domestic quantity demanded? The amount of imports?**
- E. Calculate the loss of consumer surplus as a result of the tariff.**