

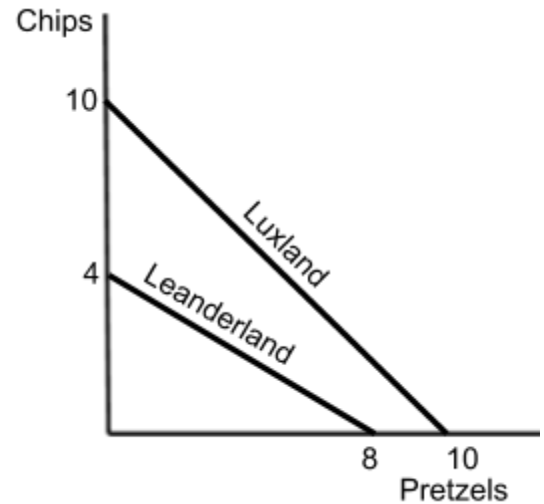


AP Macro Topic 1.3

Comparative Advantage and Trade

Part 1: Output Questions- The diagram below shows the production possibilities curves for two countries: Luxland and Leanderland. Using equal amounts of resources, Luxland can produce 10 chips or 10 pretzels, whereas Leanderland can produce 4 chips or 8 pretzels.

1. Identify which country has the absolute advantage in chips.
2. Identify which country has the absolute advantage in pretzels.
3. Calculate the opportunity cost of producing one chip in Luxland.
4. Calculate the opportunity cost of producing one pretzel in Leanderland.
5. Identify which country has the comparative advantage in pretzels.
6. Identify which country has the comparative advantage in chips.
7. If the two countries specialize and trade, which country will import chips? Explain.
8. If the terms of trade are 4 chips for 1 pretzel, would trade be advantageous for Luxland? Explain.
9. If the terms of trade are 4 chips for 1 pretzel, would trade be advantageous for Leanderland? Explain.
10. Assume that Luxland and Leanderland specialize and trade in a way that is advantageous for both of them. Explain what will happen to the number of pretzels that Leanderland can produce.



Part 2: Stretch Your Thinking- Answer the following questions assuming that advancements in technology cause Leanderland to double the amount of chips and pretzels they can produce.

11. Which country has the comparative advantage in the production of chips? Explain.
12. Identify a terms of trade that would be advantageous for both countries.



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Part 3: Input Questions- *The table below gives the production alternatives of two countries that are producing cookies and milk. The numbers represent the amount of hours it takes to produce one crate of cookies and one barrel of milk.*

INPUT HOURS OF LABOR		
Country	Cookies	Milk
Atlantis	2 hours	1 hour
Neverland	4 hours	1 hour

13. Identify which country has an absolute advantage in the production of cookies and which has the absolute advantage in the production of milk. Explain.
14. Identify which country has a comparative advantage in the production of cookies and which has a comparative advantage in the production of milk. Explain.
15. With specialization and trade, which country will import cookies? Explain.
16. Assume that the two countries decide to specialize according to their comparative advantages and that one milk is exchanged for one cookie, should Atlantis produce milk domestically or import milk from Neverland? Explain.
17. Identify a fair terms of trade that would be advantageous for both countries. Explain how you determined your answer.
18. Assume that Neverland discovers new technology that will increase their daily production of milk only. Which country has a comparative advantage in cookie production? Explain how you determined your answer.